THE WRONG TOOL FOR THE JOB: THE IP PROBLEM WITH NONCOMPETITION AGREEMENTS

VIVA R. MOFFAT*

ABSTRACT

This Article argues that employee noncompetition agreements ought to be unenforceable. It begins by recognizing that there is momentum for change in the law of noncompetes: a number of states and the American Law Institute (ALI) are in the process of reconsidering noncompete doctrine, and recent empirical studies provide evidence as to the mostly negative effects of the agreements. Existing critiques have focused on the problematic nature of noncompetes within the employment relationship. This Article synthesizes those critiques, adding support from empirical studies, and then examines noncompetes from a new perspective.

Commentators have neither recognized nor evaluated the role noncompetes play in the intellectual property (IP) system. Upon closer examination, it becomes clear that the primary justification put forth in support of noncompetes is an IP justification: the arguments in favor of enforcement of the agreements revolve around the need to protect intangibles and the need to provide incentives for invention and investment. The IP justification is pervasive and rhetorically powerful but ultimately flawed. First, trade secret and other IP protections are intentionally limited to provide a certain amount of, but not too much, protection. Allowing enforcement of noncompetes in order to protect IP thus interferes with the contours of IP protection. Second, even to the extent that IP law is insuffi-

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* Assistant Professor, University of Denver Sturm College of Law. Thanks to participants at the 2009 Intellectual Property Scholars' Conference and the Rocky Mountain Junior Scholars' Forum for excellent feedback on earlier versions of this Article. Thanks also to Rachel Arnow-Richman, Alan Chen, Sam Kamin, Paul Ohm, Wendy Seltzer, Harry Surden, and Ryan Vacca for commenting on drafts. Heidi Haberman and Diana Mead provided outstanding research assistance. Finally, I am grateful for support from the Chu Family Faculty Fellowship.

cient—that is, unintentionally limited—noncompetes are not the right tool for the IP job. A prohibition on the enforcement of noncompetes would thus serve a channeling function, directing efforts to protect intangibles to the IP regimes and encouraging the development of the appropriate IP balance, which is, of course, a work in progress.

TABLE OF CONTENTS

INTRODUCTION 876
I. THE CLASSIC PROBLEMS WITH NONCOMPETES 879
A. The Standard Justification for Noncompetes 881
B. Undermining the Freedom of Contract Rationale 884
1. Noncompetes Are the Product of an Inherently Flawed Bargaining Process 885
2. Noncompetes Restrict Employee Mobility and the Free Flow of Labor 893
II. THE FAILURE OF THE IP JUSTIFICATION 898
A. The Misplaced IP Justification for Noncompetes 899
1. The IP Justification for Noncompetes 899
2. Intellectual Property Policy 904
B. Noncompetes Fail as an IP Tool 911
CONCLUSION 921

INTRODUCTION

As intangible assets have become more valuable and increasingly difficult to control, business owners have turned to a variety of mechanisms to protect these assets. They have adopted a "belt-and-suspenders" approach. In addition to taking advantage of IP, contract, and tort law tools, firms have increasingly been asking employees to sign noncompetes[1]—contracts in which employees agree not to compete with the employer after the termination of the employment relationship.[2] As the use of noncompetes has become more widespread, controversy over these agreements has also increased. In the last few years, at least six states have reconsidered the doctrine concerning enforceability of such agreements.[3] Currently,

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1. These may be stand-alone agreements or provisions in employment contracts, and they are variously referred to as non-competes, noncompetes, noncompetition agreements, and covenants not to compete. I use the term noncompete here, but the meanings are interchangeable.

2. *See* Rachel Arnow-Richman, *Cubewrap Contracts and Worker Mobility: The Dilution of Employee Bargaining Power via Standard Form Noncompetes*, 2006 MICH. ST. L. REV. 963, 981 n.59 [hereinafter Arnow-Richman, *Dilution of Employee Bargaining Power*] ("While there is a dearth of statistical research on this issue, commentators generally agree based on anecdotal evidence and informal studies that employers' use of noncompetes and pursuit of claims for breach of such agreements are on the rise."); *see also* Christine M. O'Malley, Note, *Covenants Not To Compete in the Massachusetts Hi-Tech Industry: Assessing the Need for a Legislative Solution*, 79 B.U. L. REV. 1215, 1216 (1999) ("[H]i-tech companies have increasingly relied on broad non-compete clauses in employment agreements." (citing Hanna Bui-Eve, Note, *To Hire or Not To Hire: What Silicon Valley Companies Should Know About Hiring Competitor's Employees*, 48 HASTINGS L.J. 981, 985 (1997))).

3. *See, e.g.*, IDAHO CODE ANN. § 44-2701 (2008) (validating noncompetes between an employer and a "key employee" or a "key independent contractor"); N.Y. LAB. LAW § 202-K (Consol. 2003 & Supp. 2010) (restricting enforcement of noncompetes in broadcasting contracts); OR. REV. STAT. ANN. § 653.295 (West 2009) (presuming that noncompetes are void, but enforcing agreements under some circumstances); H.B. 4607, 186th Gen. Court (Mass. 2010), *available at* http://www.malegislature.gov/Bills/BillText/8489 (providing for the continued enforceability of noncompetes, subject to equitable exceptions, and including provisions for employees and employers to receive attorneys' fees for successfully defending noncompetes, choice of law provisions, and the continued protection of trade secrets by other lawful means); H.B. 173, 150th Gen. Assem., Reg. Sess. (Ga. 2009), *available at* http://www.legis.state.ga.us/legis/2009_10/pdf/hb173.pdf (expanding enforceability of noncompetes); H.B. 4040, 96th Gen. Assem., Reg. Sess. (Ill. 2009), *available at* http://www.ilga.gov/legislation/96/HB/PDF/09600HB4040lv.pdf (restricting, but not eliminating, noncompete enforcement).

noncompetes are enforceable in a majority of states,[4] but a few states simply refuse to enforce the agreements. The California Supreme Court roundly condemned noncompetes on public policy grounds in a recent opinion reaffirming that state's blanket rule against enforceability.[5] The ALI is in the process of drafting a Restatement of Employment Law that includes a provision permitting enforcement of noncompetes.[6] The stark differences in state law have made it possible for scholars to undertake empirical projects concerning noncompetes,[7] and these studies do not provide support for continued use of the agreements.[8] The results of these recent studies on noncompetes and the momentum for reform indicate that the time is ripe for a thorough reexamination of the use of and justifications for noncompetes.

Employment law scholars have paid a great deal of attention to two aspects of noncompetes: they have critiqued the agreements as the product of a flawed bargaining process and as being fundamentally unfair to employees.[9] Few scholars, however, have paid attention to another aspect of noncompetes—the fact that they are widely used to protect IP and IP-like assets.[10] Taking a fresh look at noncompetes requires both a reevaluation of the agreements as a

4. *See* Mark J. Garmaise, *Ties that Truly Bind: Noncompetition Agreements, Executive Compensation, and Firm Investment*, J.L. ECON. & ORG., Nov. 3, 2009, at 13-14, 44, http://jleo.oxfordjournals.org/content/early/2009/11/03/jleo.ewp033.full.pdf+html.

5. Edwards v. Arthur Anderson L.L.P., 189 P.3d 285, 291 (Cal. 2008); *see* CAL. BUS. & PROF. CODE § 16600 (West 2008). A few other states take the same position, rendering employee noncompetition agreements unenforceable, with just a few narrow exceptions. *See, e.g.*, N.D. CENT. CODE § 9-08-06 (2010) (containing language identical to California's statute). The North Dakota statute reflects North Dakota's "long-standing public policy against restraints upon free trade." Warner & Co. v. Solberg, 634 N.W.2d 65, 69-70 (N.D. 2001). In California, the exceptions to enforceability are noncompetes in the context of a sale of a business, a partnership arrangement, and an action to protect goodwill. CAL. BUS. & PROF. CODE §§ 16601-16602 (West 2008).

6. RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 8.06 (Preliminary Draft No. 7, 2010) ("[A] covenant in an agreement between the employer and the former employee restricting a former employee's activities is enforceable if it is reasonably tailored in scope, geography, and time to further a protectable interest of the employer.").

7. *See infra* notes 167-72 and accompanying text.

8. *See infra* notes 79-84, 167-72 and accompanying text. This conclusion could be stated in a stronger form—that studies provide support for a rule against enforcement of noncompetes—but that may be taking the evidence a bit too far and is not necessary for the argument here.

9. *See infra* notes 41-45 and accompanying text.

10. *See infra* note 88.

part of the employment relationship and an understanding of the agreements in the context of IP regulation.

The existing critiques are powerful. Employment law scholars have explored some of the problematic aspects of noncompetes, focusing their attacks on the freedom of contract rationale for enforcement of the agreements.[11] In particular, they have emphasized that noncompetes result from a deeply flawed bargaining process and impose significant restrictions on employee mobility.[12] These critiques, which recent empirical studies of the effects of noncompetes on individuals and the broader labor market support, have led to suggestions for a variety of doctrinal fixes.[13]

What has gone virtually unnoticed, however, is the primary argument put forth in favor of noncompetes—the IP justification. It proceeds as follows: noncompetes are necessary to protect trade secrets or other IP assets, or they are necessary to provide an incentive for firms to invent and invest.[14] The main thrust of the justification is that other forms of protection, primarily trade secret law, are too weak and that noncompetes are necessary to supplement IP rights, or as an alternative to these rights.[15]

The IP justification, whether explicit or implicit, fails in the context of employee noncompetes. To some extent at least, trade secret law and other forms of protection for intangibles are *intentionally* limited, performing a channeling function by directing some inventions to the patent regime and others to the public domain.[16] Even to the extent that trade secret law is *unintentionally* weak, the IP justification for noncompetes is not compelling because noncompetes are not a good tool for achieving the purposes of IP protection.[17] In either event, a refusal to enforce noncompetes would serve a channeling function, directing efforts to protect intangibles

11. *See infra* Part I.B.
12. *See infra* Part I.B.
13. *See infra* notes 73-84 and accompanying text.
14. *See infra* Part II.A.1.
15. *See infra* Part II.A.1.
16. This is not to say that trade secret law is perfectly calibrated, but only that it, like other areas of IP protection, entails some effort to balance the rights of owners with other interests, as well as with other forms of IP protection. *See infra* Part II.
17. *See infra* Part II.B.

to the IP regimes, rather than allowing an end run around these regimes with a tool that is so problematic in other ways.

Neither employment law scholars nor IP scholars have explored or challenged the understanding of noncompetes as an IP tool. Taking into account both the long-standing view of noncompetes as the product of a flawed bargaining process and the new understanding of noncompetes as misguided efforts to protect IP, there remain no persuasive arguments in favor of enforcing the agreements.

This Article proceeds as follows: In Part I, I describe the freedom of contract rationale in the context of employee noncompetes and summarize the critiques, primarily from employment law scholars, that undermine that justification. These critiques focus on the flaws in the bargaining process and the restrictions on employee mobility. In addition, recent empirical studies support the theoretical arguments against noncompetes, demonstrating the weakness of the freedom of contract rationale. In Part II, I turn to the largely unexamined IP justification for noncompetes and argue it is much less compelling than the rhetoric would imply. Noncompetes should be understood as used primarily to protect intangible assets, but they are simply the wrong tool for the job. Finally, I conclude that the arguments in favor of noncompetes are so weak that use of the agreements cannot be justified. Although the long-standing critiques of noncompetes undermine the arguments in favor of enforcement, it is the failure of the IP justification that leads to the conclusion that the agreements should simply be unenforceable. State legislatures, rather than courts, however, must implement this reform.

I. THE CLASSIC PROBLEMS WITH NONCOMPETES

Firms are increasingly using noncompetes to restrict the post-employment activities of current employees, limiting the type, location, and extent of subsequent employment.[18] They may be stand-alone agreements or part of a broader employment agreement, and they may be entered into at the outset of the employment relationship, in the midst of it, or at the termination of employment.

18. *See supra* note 2.

In many jurisdictions, the agreements will be enforced if they are deemed necessary to protect an employer's "legitimate interests" and are "reasonable" in terms of the restrictions imposed upon the employee.[19] Notably, however, noncompetes are simply unenforceable in a few states, regardless of the employer's "interests" and the reasonableness of the provisions.[20] These differences in state law are the result of the conflicting public policy concerns raised by the use of these agreements: the free flow of labor and freedom of contract.

The increased use of noncompetes, along with the conflicting policy concerns they implicate, has led to controversy over their use and effects. State courts have been tinkering with the doctrine, a number of legislatures have considered or passed noncompete statutes, and the ALI is drafting noncompete provisions as part of its Restatement (Third) of Employment Law.[21]

Thus the time is ripe for a reevaluation of the use and enforceability of noncompetition agreements. A fresh look at noncompetes requires a reevaluation of the existing scholarly approaches. These have primarily come from employment law scholars focused, understandably, on the operation of noncompetes as part of the employment relationship. In this Part, I briefly describe the freedom

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19. In most states, courts apply some variation on the common law "rule of reason," examining the effects on the employee, the needs or interests of the employer, and the public interest to evaluate whether a given restriction is reasonable. *See, e.g.*, Roanoke Eng'g Sales Co. v. Rosenbaum, 290 S.E.2d 882, 884 (Va. 1982) (applying a three-part balancing test, assessing whether the restraint is reasonable (1) "from the standpoint of the employer ... in the sense that it is no greater than is necessary to protect the employer in some legitimate business interest"; (2) "[f]rom the standpoint of the employee ... in the sense that it is not unduly harsh and oppressive in curtailing his legitimate efforts to earn a livelihood"; and (3) "from the standpoint of a sound public policy"); RESTATEMENT (SECOND) OF CONTRACTS § 188 (1981) (stating that a court must consider (1) whether "the restraint is greater than is needed to protect the [employer's] legitimate interest," (2) the hardship to the employee, and (3) "the likely injury to the public").

20. Although California and a few other states currently have strong rules prohibiting enforcement of noncompetes, *see supra* note 5 and accompanying text, the agreements are generally enforceable in most states. No jurisdiction takes a pure private ordering approach, however. *See* Cynthia L. Estlund, *Between Rights and Contract: Arbitration Agreements and Non-Compete Covenants as a Hybrid Form of Employment Law*, 155 U. PA. L. REV. 379, 395 (2006) [hereinafter Estlund, *Between Rights*] ("Across the country, however, postemployment covenants not to compete are subject not merely to the ordinary requirements of contract law but to additional substantive conditions that external law imposes on these agreements in particular.").

21. *See supra* notes 3-6 and accompanying text.

of contract rationale and the extent to which critiques from employment law scholars and the results of recent empirical work erode that justification in the context of employee noncompetes.

A. The Standard Justification for Noncompetes

As with all contracts, a fundamental justification for noncompetes is the freedom of contract principle.[22] The principle is generally animated by a free market ethos: independent actors should be free to enter into any agreements they choose.[23] Underlying this ethos is the assumption that market-based transactions will be more efficient.[24] Thus the default rule is that agreements will be enforced and that courts will not interfere with the substance of those agreements, with exceptions for circumstances in which the voluntariness of the agreement is particularly suspect, for example, in cases of misrepresentation, duress, or unconscionability.[25] This approach is consistent with the neoclassical model of promoting bargained-for agreements but rejecting those agreements that are the product of a significantly flawed bargaining process.[26]

Courts will rarely invoke these doctrines to hold individual contracts unenforceable, much less *classes* of contracts.[27] Standard-form

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22. *See, e.g.*, Edmund W. Kitch, *The Law and Economics of Rights in Valuable Information*, 9 J. LEGAL STUD. 683, 686 (1980) ("The central issue is not the desirability of such contractual arrangements in particular cases but why employer and employee are not free to enter into arrangements that they consider desirable in light of the circumstances. Why doesn't the usual assumption that contracting parties can protect their own interests control here as elsewhere?").

23. *Id.*

24. *See, e.g.*, MICHAEL J. TREBILCOCK, THE LIMITS OF FREEDOM OF CONTRACT 15-16 (1997) (stating that "neo-classical economists have a predilection for resource allocation through voluntary exchanges as opposed to collective decisions because they believe that one can have a higher degree of confidence in the welfare implications of private exchanges").

25. U.C.C. § 2-302 (2009) (unconscionability); RESTATEMENT (SECOND) OF CONTRACTS § 164 (1981) (misrepresentation); *id.* § 175 (duress).

26. *See* Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293, 293 (1975) ("The classical conception of contract at common law had as its first premise the belief that private agreements should be enforced in accordance with their terms. That premise of course was subject to important qualifications. Promises procured by fraud, duress, or undue influence were not generally enforced by the courts.").

27. *See* Charles A. Sullivan, *The Puzzling Persistence of Unenforceable Contract Terms*, 70 OHIO ST. L.J. 1127, 1170 (2009) ("[O]nce an agreement passes these various, large-grained screens, the courts generally seem to feel compelled to enforce it.").

consumer contracts, for example, have been roundly criticized on a variety of fronts, yet their continued use is certainly not in jeopardy.[28] As is true of noncompetes,[29] standard-form consumer contracts depart fairly radically from the neoclassical model of contracting: they are the product of vastly unequal bargaining power, the terms generally favor the drafter,[30] in many circumstances there is slim possibility of opting out, and they are, as a practical matter, never negotiated. But in the consumer contract context, the arguments in favor of enforceability—efficiency and practicality, primarily—retain a great deal of force.[31] It is nearly impossible to imagine a world in which there are no consumer contracts, or in which every contract accompanying a camera or a computer or even a new pair of jeans bought online must be individually negotiated and discussed.[32] As a general matter, the freedom of contract rationale provides a strong argument for robust

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28. *See, e.g.*, Randy E. Barnett, *Consenting to Form Contracts*, 71 FORDHAM L. REV. 627, 627 (2002) ("In practice, form contracts are ubiquitous."); Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1235-38 (1983) (setting forth the now-classic critique of contracts of adhesion, but also concluding that "[i]f business firms play an important part in maintaining such a society, and if their ability to do so depends significantly on the use of standard forms, perhaps enforcement of the forms can be justified"). Along with many others, I have argued that adhesion contracts ought to be policed more strictly. *See* Viva R. Moffat, *Super-Copyright: Contracts, Preemption, and the Structure of Copyright Policymaking*, 41 U.C. DAVIS L. REV. 45, 45 (2007) (arguing that adhesion contract terms limiting fair use ought to be preempted).

29. *See infra* Part I.B.1.

30. *But see* Florencia Marotta-Wurgler, *Are "Pay Now, Terms Later" Contracts Worse for Buyers? Evidence from Software License Agreements*, 38 J. LEGAL STUD. 309, 312 (2009) ("At least with respect to software license terms, buyers do not, on average, receive more pro-seller contracts when the terms are disclosed only after purchase. Scholars and consumer advocates, then, should not be particularly concerned about rolling contracts. It is important to note, however, that the tests in this paper cannot answer the broader question of whether all [end-user license agreements], or standard-form contracts in general, contain poor-quality terms according to some absolute standard.").

31. Sullivan, *supra* note 27, at 1148.

32. It is difficult to know what percentage of consumer contracts are standard-form agreements, but scholars agree that they are very widely used. *See* Arnow-Richman, *Dilution of Employee Bargaining Power, supra* note 2, at 977 n.51 ("While there is little empirical evidence about the number of standard form contracts relative to the number of contracts generally, scholars agree that standardized forms are ubiquitous and represent the dominant mode of private ordering in the contemporary economy." (citing Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1203 (2003); W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 529 (1971))).

and hands-off contract enforcement in all but the most egregious cases.[33]

In the noncompete context, the more specific version of the freedom of contract argument is that "human capital" ought to be fully alienable, primarily for efficiency reasons.[34] Professor Stewart Sterk argues, for example, that

> [i]n justifying these restraints [on alienability], ... courts and scholars have rarely considered an important distributional effect of these restraints on alienation: the persons most likely to benefit from rules that keep future earning capacity in the hands of its original holder are those persons best endowed with the talents, skills, and knowledge that contribute to that earning capacity.[35]

This is, essentially, an efficiency-based argument, and Sterk describes a refusal to enforce noncompetes as paternalistic: "courts or legislatures substitute social judgments about the appropriate trade-offs between compensation and future freedom for the decisions parties make by contract."[36] Noncompetes are thus justified on the same freedom of contract rationale that animates contract law generally.

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33. Stewart E. Sterk, *Restraints on Alienation of Human Capital*, 79 VA. L. REV. 383, 412 (1993) ("[I]f the owner of more traditional forms of property sells or restricts his future use of that property—as might be the case with the grant of an easement, for instance—courts are unlikely to invalidate the transfer years later unless presented with evidence of fraud or overreaching in the original bargain.").

34. Maureen B. Callahan, Comment, *Post-Employment Restraint Agreements: A Reassessment*, 52 U. CHI. L. REV. 703, 705 (1985) ("The willingness of courts to make independent judgments about the reasonableness of post-employment restraints imposes significant costs that would be avoided by the general rule of nonintervention."). Note that the alleged need to protect or invest in "human capital" is another version of the IP justification. Human capital is perhaps the epitome of an intangible, and the various IP regimes and rules governing the workplace deal with who, if anyone, owns various aspects of human capital.

35. Sterk, *supra* note 33, at 385. This Article takes a position nearly diametrically opposed to Sterk's. Sterk contends that the arguments for limiting noncompete enforcement are particularly weak. "The principal justifications for refusing to enforce 'unreasonable' covenants not to compete, however, are insufficient." *Id.* at 387. Sterk "concludes that the existing doctrinal structure, which requires fact-specific judicial evaluation of covenants for reasonableness, rests on foundations that are problematic at best." *Id.*

36. *Id.* at 411-12.

B. Undermining the Freedom of Contract Rationale

The neoclassical model from which the freedom of contract ideal springs assumes that contracts are the result of a relatively equal, arms-length negotiation process. Notwithstanding the theoretical argument concerning the efficiency of noncompetes, they depart radically from the neoclassical model. Employment law scholars, primarily, have demonstrated the weakness of the rationale in the noncompete context.

In examining the use and operation of noncompetes, these scholars have, understandably, focused on noncompetes as an aspect of the employment relationship or in the context of the broader labor market. In doing so, they have identified two problematic aspects of the use of noncompetes: first, the agreements result from a deeply flawed bargaining process; second, they restrict employee mobility.[37] Recent empirical work bolsters these critiques.

The bargaining process concerns are multifaceted but exemplified by the fact that the agreements are rarely negotiated and, indeed, are often entered into well after the employment relationship has begun. An agreement may state, for example, in its preamble: "In consideration of my employment or *continued employment*, ... [employee] agree[s] with the Company as follows...."[38] And noncompetes are, of course, designed to restrict employee mobility, regularly limiting the types of future employment that employees may accept for a year or more. The same sample agreement provides that the employee

> *will not*, during the period of [her] employment by the Company and in the event that [her] employment with the Company is terminated for any reason whatsoever and whether such termination be voluntary or involuntary, *for a period of three years* (3) following such termination, (i) directly or indirectly engage in any competitive business.[39]

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37. Arnow-Richman, *Dilution of Employee Bargaining Power*, *supra* note 2, at 966.

38. Sample Noncompete from GT Solar Inc., http://contracts.onecle.com/gt-solar/woodbury-non-competition-2008-01-07.shtml (last visited Nov. 12, 2010) [hereinafter Sample Agreement] (emphasis added).

39. *Id.* (emphasis added). Some other significant aspects of this exemplary agreement will be addressed in Part II. For now, it is sufficient to keep in mind that (1) the agreement makes explicit that its purpose is to protect the employer's IP; (2) the employer's "Proprietary

Parts I.B.1-2 elaborate on these two concerns and incorporate the results of several recent empirical studies that confirm some of the theoretical critiques.

1. Noncompetes Are the Product of an Inherently Flawed Bargaining Process

Given the obvious negative consequences for an employee of entering into a noncompete—the inability to work for certain employers, in certain places, for some extended period of time—the logical question is *why* do employees do so? The answer likely lies in the circumstances surrounding the bargaining process.

Commentators have discussed the systematically unequal bargaining power between employees and employers in general, and the extent to which that plays out in the drafting, negotiation, and enforcement of noncompetes.[40] In arguing for the reform of noncompete doctrine, many scholars have focused on these arguments. I synthesize these arguments in this Section, along with the results of recent empirical work, and conclude that these arguments remain powerful critiques of noncompetes.

Employee-employer relations are characterized by unequal bargaining power: as a general matter, employers have vastly more power in the negotiation and performance of the employment relationship.[41] This asymmetry heavily influences the existence and character of employee noncompetes. They are uniformly drafted by

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Information" is defined very broadly to include everything from systems and formulae to price and customer lists; and, finally, (3) the agreement references the "highly competitive nature of the business of the Company" and states that the purpose of the agreement is to "prevent any competitive business from gaining any unfair advantage from [the employee's] knowledge of Proprietary Information." *Id.*

40. *See infra* notes 41-45 and accompanying text.

41. Employment law scholars have explored this subject in depth. *See, e.g.*, Arnow-Richman, *Dilution of Employee Bargaining Power*, *supra* note 2, at 963 ("Employment relationships are perhaps the paradigmatic example of inequality of bargaining power in contract law."); Mayer G. Freed & Daniel D. Polsby, *Just Cause for Termination Rules and Economic Efficiency*, 38 EMORY L.J. 1097, 1099 (1989) ("The most commonly encountered market failure idea is the inequality of bargaining power that supposedly subsists between the employer and employee. This notion of inequality of bargaining power pervades discussions about regulation of the employment relationship."). *See generally* Daniel D. Barnhizer, *Inequality of Bargaining Power*, 76 U. COLO. L. REV. 139 (2005) (discussing the concept of inequality of bargaining power in contract law).

the employer and only rarely negotiated by the employee. As such, they nearly always favor the employer.[42] The comments to the Restatement of Contracts provision on noncompetes put it succinctly: "Post-employment restraints are scrutinized with particular care because they are often the product of unequal bargaining power and because the employee is likely to give scant attention to the hardship he may later suffer through loss of his livelihood."[43] Commentators have noted the increased use of boilerplate employment agreements[44] and the one-sided nature of those agreements.

42. *See* Estlund, *Between Rights*, *supra* note 20, at 384 ("Most employment contracts arise between individuals who are more or less dependent on a single job and comparatively large organizations that are repeat players with diversified investments in the labor market. Most contract terms are offered by employers on a take-it-or-leave-it basis, and are set under the shadow of employment at will—the employer's presumptive power to fire employees for any reason at all, including refusal to accept the employer's proferred or modified terms of employment."); *see also* O'Malley, *supra* note 2, at 1216 ("In a typical situation, the hi-tech employer drafts a non-competition agreement and compels the prospective employee, who lacks bargaining power and legal sophistication, to sign it as a condition of employment. As a result, most non-competition agreements contain a strong bias in the employer's favor."); Griffin Toronjo Pivateau, *Putting the Blue Pencil Down: An Argument for Specificity in Noncompete Agreements*, 86 NEB. L. REV. 672, 676 (2008) (noting that "noncompete agreements are almost invariably drafted in favor of the employer" (citing Kenneth J. Vanko, *"You're Fired! And Don't Forget Your Noncompete..." The Enforceability of Restrictive Covenants in Involuntary Discharge Cases,* 1 DEPAUL BUS. & COM. L.J. 1, 1 (2002))). Law and economics scholars, on the other hand, have pushed back against the notion that employees are systematically disadvantaged in bargaining with their employers or potential employers. *See, e.g.*, Estlund, *Between Rights*, *supra* note 20, at 388 n.18 ("Law-and-economics scholars have repeatedly criticized the 'unequal bargaining power' claim and argued for greater deference to contracts." (citing Stewart J. Schwab, *The Law and Economics Approach to Workplace Regulation*, *in* GOVERNMENT REGULATION OF THE EMPLOYMENT RELATIONSHIP 91, 111-13 (Bruce E. Kaufman ed., 1997); Michael L. Wachter & Randall D. Wright, *The Economics of Internal Labor Markets*, 29 INDUS. REL. 240, 260 (1990))); *see also* Michael H. Gottesman, *Wither Goest Labor Law: Law and Economics in the Workplace*, 100 YALE L.J. 2767, 2770-71 (1991) (book review) (discussing the debate between "adherents of neoclassical economics who contend that there is no reason for the law to treat the sale of labor differently from the sale of products" and those who, for example, argue that "collective bargaining ... truly is the most effective ordering principle for the workplace").

43. RESTATEMENT (SECOND) OF CONTRACTS § 188 cmt. g (1981). The drafters of the Restatement (Third) of Employment Law have apparently struggled with the proper approach to take. The draft provision permits limited enforcement of noncompetes, and it does not appear to acknowledge the bargaining process concerns. RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 8.06 (Preliminary Draft No. 7, 2010).

44. Limited empirical work exists concerning the frequency with which employees enter into noncompetes. There is surely variation by jurisdiction, by industry, by type of employer, and by type of employee. Commentators seem to assume that the use of noncompetes is increasing, but there is little data to support this assumption. *See* Toby E. Stuart & Olav Sorenson, *Liquidity Events and the Geographic Distribution of Entrepreneurial Activity*, 48

In many instances, the purpose "is not to memorialize a negotiated set of terms, but to extract waivers of rights, thus realigning statutory and default rules to better reflect employers' interests."[45]

Given the one-sided nature of the noncompetition obligation, one might expect that employees take on noncompetition restrictions in exchange for something of significance, such as higher salaries or status or better benefits.[46] This intuition is theoretically compelling, but some evidence indicates that the contrary might, in fact, be true: employees subject to noncompetes may receive *less* in the employment bargain. One study found "that tougher noncompetition enforcement promotes executive stability"—that is, decreased mobility —as well as "*reduced* executive compensation."[47] Although these findings undercut the standard freedom of contract view of bargaining, they are not entirely surprising upon further reflection. In jurisdictions in which noncompetes are enforced, an employee's market power, and therefore ability to negotiate for better terms, is reduced.

Perhaps because noncompetes are rarely negotiated and rarely challenged in court, employers have a tendency to overreach,

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ADMIN. SCI. Q. 175, 182 (2003) ("The prevalence of non-compete covenants in employment contracts remains unknown, but available data suggest that they may be nearly ubiquitous in employment contracts in high technology businesses. Kaplan and Strömberg (2000), for example, found that venture capital firms required 90 percent of the founders of the companies they financed to sign non-compete agreements. In a broader survey, Leonard (2001) reported that 88 percent of companies with less than $50 million in sales require employees to sign non-compete covenants."). Another study, citing many of the same sources, states that "[n]on-competes appear to be nearly universal in employment contracts." Matt Marx, Deborah Strumsky & Lee Fleming, *Mobility, Skills, and the Michigan Non-Compete Experiment*, 55 MGMT. SCI. 875, 876 (2009).

45. Rachel Arnow-Richman, *Cubewrap Contracts: The Rise of Delayed Term, Standard Form Employment Agreements*, 49 ARIZ. L. REV. 637, 639 (2007) [hereinafter Arnow-Richman, *Delayed Term*].

46. *See, e.g.*, Sterk, *supra* note 33, at 408 ("[D]enying the monopsonist power to enforce restrictive covenants would simply cause the monopsonist to exercise that power in a different way—for instance, by offering lower wages. Refusing to enforce restrictive covenants would not reduce the monopsonist's power."). The same argument is made concerning standard-form consumer contracts: "If one seller offers unattractive terms, a competing seller, wanting sales for himself, will offer more attractive terms." RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 114 (4th ed. 1992). *But see* Sullivan, *supra* note 27, at 1149-50 ("Valid noncompetition clauses tend to deter a firm's employees ... from working for a competitor or, indeed, from leaving its employ at all.... Not only does this tend to keep valued employees in their jobs, but the unavailability or lesser attractiveness of alternative employment should tend to depress the compensation the employer needs to pay these 'captive' workers.").

47. Garmaise, *supra* note 4, at 1 (emphasis added).

drafting noncompetes that are quite broad and possibly unenforceable. This issue is obviously subject to empirical proof, but many courts and commentators believe that employer overreach is a significant problem,[48] and anecdotal evidence supports this view.[49] This tendency to overreach creates *in terrorem* effects: employees will refrain from lawful, permissible behavior out of concern for complying with the contract and avoiding litigation.[50]

The *in terrorem* effects are magnified—because employers are more likely to overreach—in jurisdictions that allow "blue pencil-

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48. Sullivan, *supra* note 27, at 1150 (discussing the widespread use of overbroad noncompetition agreements). Although empirical evidence may be hard to come by, "[c]oncerns about the *in terrorem* effects of [noncompetes] ... have been voiced with frequency." Arnow-Richman, *Dilution of Employee Bargaining Power*, *supra* note 2, at 966 n.10. Cynthia Estlund states:

> In both [noncompetes and arbitration agreements], employers have an incentive to overreach—to use these agreements to impair employees' inalienable rights, injure the public interest, or both. The loss of a valued employee, especially to a competitor, is undesirable; the employer may be tempted to secure as much insulation from that loss, and from that future competition, as its market power will permit.

Estlund, *Between Rights*, *supra* note 20, at 412; *see also* Rachel Arnow-Richman, *The Role of Contract in the Modern Employment Relationship*, 10 TEX. WESLEYAN L. REV. 1, 5 (2003).

49. One anecdotal piece of evidence: During my time in practice, I was asked by one client to draft a noncompete for all employees in a small company. I responded that the terms suggested by the client would be unenforceable. The client responded: "I don't care. I just don't want them to leave."

50. *See* Estlund, *Between Rights*, *supra* note 20, at 406 ("An overbroad noncompete—one that lasts too long or that covers activities that do not threaten the employer's legitimate interests—may deter the employee from quitting and competing even when she has a right to do so, or it may deter a competitor from hiring the employee."); *see also* Richard P. Rita Pers. Servs. Int'l, Inc. v. Kot, 191 S.E.2d 79, 81 (Ga. 1972) ("For every covenant that finds its way to court, there are thousands which exercise an *in terrorem* effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors. Thus, the mobility of untold numbers of employees is restricted by the intimidation of restrictions whose severity no court would sanction." (quoting Harlan M. Blake, *Employee Agreements Not To Compete*, 73 HARV. L. REV. 625, 682-83 (1960))); Reddy v. Cmty. Health Found. of Man, 298 S.E.2d 906, 916 (W. Va. 1982) (describing broad noncompete provisions in employment agreements "where savage covenants are included in employment contracts so that their overbreadth operates, by *in terrorem* effect, to subjugate employees unaware of the tentative nature of such a covenant"). Even those commentators who generally support the enforceability of noncompetes concede that overreaching—and its effect on employees—may occur. *See, e.g.*, Sterk, *supra* note 33, at 410 ("[B]y limiting the number of attractive alternatives available to an employee, a restrictive covenant may in some sense 'coerce' that employee to remain with his initial employer.").

ing," or reformation of the contract to make it reasonable.[51] Both commentators and courts have noted the incentive to overreach when blue penciling may occur.[52] A Georgia court described the dynamic as follows:

> Employers covenant for more than is necessary, hope their employees will thereby be deterred from competing, and rely on the courts to rewrite the agreements so as to make them enforceable if their employees do compete. When courts adopt severability of covenants not to compete, employee competition will be deterred even more than it is at present by these overly broad covenants against competition.[53]

The *in terrorem* effects may even extend to other employers, reducing employee mobility further. For example, one court, refusing to blue pencil a noncompete covenant, stated that "[a] prospective new employer ... could not read the [noncompete provision] and know what sorts of activity would be prohibited and what would not."[54] As a result, the court concluded "[a] current employee may be frozen in his or her job by an unreasonably broad covenant. Even if the employee believes the covenant is too broad,

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51. Pivateau, *supra* note 42, at 690-91 ("In those states employing the [blue pencil] doctrine, employers are effectively encouraged to enter into otherwise unenforceable agreements."); *see also* Valley Med. Specialists v. Farber, 982 P.2d 1277, 1286 (Ariz. 1999) ("Employers may therefore create ominous covenants, knowing that if the words are challenged, courts will modify the agreement to make it enforceable."); *Kot*, 191 S.E.2d at 81 ("If severance is generally applied, employers can fashion truly ominous covenants with confidence that they will be pared down and enforced when the facts of a particular case are not unreasonable.").

52. *See, e.g.*, Philip J. Closius & Henry M. Schaffer, *Involuntary Nonservitude: The Current Judicial Enforcement of Employee Covenants Not To Compete—A Proposal for Reform*, 57 S. CAL. L. REV. 531, 547 (1984) ("The 'blue pencil rule' and the 'rewriting' of offending covenants illustrate another defect in the reasonableness approach. These practices encourage employers to be 'unreasonable' in drafting covenants not to compete because there is, in effect, no sanction for being unreasonable."); Estlund, *Between Rights*, *supra* note 20, at 405 ("Judicial willingness to edit or reform agreements ... may invite employers to overreach."); Sullivan, *supra* note 27, at 1147 ("The effect is to reduce or eliminate any incentive for employers to draft clauses that comply with the legal requirements and therefore to encourage future use of exactly the same provision.").

53. Howard Schultz & Assocs., Inc. v. Broniec, 236 S.E.2d 265, 269 (Ga. 1977).

54. Produce Action Int'l, Inc. v. Mero, 277 F. Supp. 2d 919, 930-31 (S.D. Ind. 2003).

she may be able to test that proposition only through expensive and risky litigation."[55]

Another manifestation of the asymmetrical bargaining power is that noncompete provisions are frequently presented after the employee has already accepted the position, and sometimes months or years later. The rise of standard-form, adhesive agreements in the private employment context has only exacerbated this dynamic, resulting in employment agreements that are presented in a "delayed terms" manner, much the way shrinkwrap and clickwrap contracts have presented a "pay now, terms later" situation.[56] Although employees regularly negotiate salary and benefits before accepting a job, noncompetition provisions are not often discussed, but instead presented on the first day on the job or some time thereafter.

Delayed terms—those presented after an employment agreement has been negotiated, and often after the employee has begun work —give rise to a host of problems in the employment context, and with respect to noncompetition provisions in particular. Professor Rachel Arnow-Richman describes the context in which noncompetes are often presented, likening the presentation to that of shrinkwrap contracts:

> The use of boilerplate language in any context has long raised questions about the validity of assent and the risk of overreaching by the drafter, concerns that are heightened where a delay in providing terms impedes a party's ability to consider the transaction as a whole. In the employment context, such concerns redouble given the nature of both the relationship and the market. As compared with a purchase of goods, the individual employee is likely to have much more at stake in any one "sale" and ultimately has very limited ability to reject or "return" the job once accepted. These limitations allow cubewrap contracts to operate underground as a form of private legislation, rewriting the baseline common law and statutory rules that protect employee rights and society generally.[57]

55. *Id.* at 931.

56. Arnow-Richman, *Delayed Term*, *supra* note 45, at 640 ("What has escaped wide notice in the employment law literature is that standard form employment agreements frequently follow this agreement-now-terms-later model of contracting.").

57. *Id.* at 641.

As Arnow-Richman suggests, cognitive biases only exacerbate the dynamic of unequal bargaining power.[58] People are not particularly good at estimating the risk that something may go wrong. At the outset of an employment relationship in particular, prospective employees are unlikely to dwell upon the possibility of negative outcomes that may or may not occur at some time in the future.[59]

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58. *Id.* at 654-55. For a discussion of the cognitive and behavioral biases that place employees in a particularly bad bargaining position vis-à-vis employers, see, for example, Samuel Issacharoff, *Contracting for Employment: The Limited Return of the Common Law*, 74 TEX. L. REV. 1783, 1794-95 (1996) (analogizing the hiring stage to a first date, in which one would not raise questions about dissolution of the relationship, and stating that "[t]he inherent difficulty in discussing end-term arrangements at the point of initial courtship is compounded by the general presumption of bargaining inequality for all but the most select employees"); Walter Kamiat, *Labor and Lemons: Efficient Norms in the Internal Labor Market and the Possible Failures of Individual Contracting*, 144 U. PA. L. REV. 1953, 1958 (1996) (describing difficulties on both sides of the employment bargain by stating that "[a]n employee and employer contracting for employment fits [economist George Akerlof's] model: each possesses unique access to information—information regarding the quality of their offers—that the other party would find highly relevant, but which neither party can easily discover from the other"); Pauline T. Kim, *Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World*, 83 CORNELL L. REV. 105, 106 (1997) ("[W]orkers appear to systematically overestimate the protections afforded by law, believing that they have far greater rights against unjust or arbitrary discharges than they in fact have under an at-will contract."); Cass R. Sunstein, *Human Behavior and the Law of Work*, 87 VA. L. REV. 205, 240-43 (2001) (discussing the fact that people tend to have "excessive optimism" and "inadequate foresight" about future risk, and that they "edit out" low-probability events); see also Cynthia L. Estlund, *How Wrong Are Employees About Their Rights, and Why Does It Matter?*, 77 N.Y.U. L. REV. 6, 8 (2002) [hereinafter Estlund, *How Wrong*] ("In the context of a contract between a more- and a less-sophisticated party, in which the former directly benefits from the misconceptions of the latter, a case can be made for bringing the law into line with the optimistic beliefs of the less-sophisticated party."); Cass R. Sunstein, *Switching the Default Rule*, 77 N.Y.U. L. REV. 106, 108-10 (2002) (discussing the "endowment effect" in the employment relationship). Even those scholars who urge enforcement of noncompetes recognize some of the problematic aspects of the bargaining process. *See, e.g.*, Sterk, *supra* note 33, at 408-09 ("Deficiencies in information or imagination, however, might lead employees to sign restrictive covenants that are not in their interest." (citing Freed & Polsby, *supra* note 41, at 1105-07; Lea S. VanderVelde, *The Gendered Origins of the* Lumley *Doctrine: Binding Men's Consciences and Women's Fidelity*, 101 YALE L.J. 775, 852 (1992))).

59. Arnow-Richman, *Delayed Term*, *supra* note 45, at 654 ("Indeed, the period immediately following hire is likely to be the one in which employees are most optimistic about their future employment. Beliefs about the quality and duration of employment may even be explicitly reinforced by management personnel who reassure the workers about their prospects and treat the required written documents as 'routine paperwork.'"). For more general discussions of this topic, see, for example, Jean Braucher, *Amended Article 2 and the Decision To Trust the Courts: The Case Against Enforcing Delayed Mass-Market Terms, Especially for Software*, 2004 WIS. L. REV. 753; Melvin Aron Eisenberg, *The Limits of*

Even assuming that an employer presents a noncompete provision to the employee before she begins work, the issue is unlikely to be salient at that point in the employment relationship. Unlike salary, hours, or benefits, a noncompete provision takes effect, if at all, at a point much later in time. "[N]on-compete agreements constrain employees only in a fairly remote and uncertain future event; and we may expect employees to overdiscount the likelihood of these events or the importance of the rights at stake."[60]

The combination of asymmetrical bargaining power, the form and presentation of many noncompetes, and the cognitive biases involved in the negotiation of noncompetes means that the bargaining process rarely conforms to the neoclassical vision of a freely negotiated, arms-length agreement. Many commentators have critiqued noncompete law based on these bargaining power issues, suggesting a variety of doctrinal fixes, but few have suggested an absolute rule of unenforceability.[61]

Cognition and the Limits of Contract, 47 STAN. L. REV. 211 (1995); see also Sterk, *supra* note 33, at 408-09 ("An employee beginning a new job may discount or overlook the possibility that she will later want to compete with her employer."); Rena Mara Samole, Note, *Real Employees: Cognitive Psychology and the Adjudication of Noncompetition Agreements*, 4 WASH. U. J.L. & POL'Y 289, 301 (2000) ("[C]ognitive psychologists suggest that because neoclassical economics ignores important limits on human cognition in situations involving risk or uncertainty, it relies on an idealized and impossible view of human behavior.").

60. Estlund, *Between Rights*, *supra* note 20, at 413 ("Cognitive biases or informational asymmetries might thus aggravate concerns about the fairness of bargains struck at an earlier point, especially at the outset of employment, when questions about the forum in which one might later sue the employer, or about one's ability to compete with the employer after termination, are likely to tarnish the appeal of an applicant or new employee. All of this might make it easier for employers to overreach and invade employee rights."). Even this assumes that employees can at some point fairly evaluate the legal effect of a noncompete, and empirical evidence contradicts this assumption. *See, e.g.*, Sullivan, *supra* note 27, at 1136-37 ("Empirical evidence that employees are unaware of even their most basic rights ... suggests that it would not be hard to convince employees that an overbroad noncompetition clause is valid.").

61. Arnow-Richman concludes that "no doctrinal fix will fully solve the problem of employer overreaching or employee oppression, because it does not alter the fundamental imbalance that exists whenever a single individual deals with a larger entity." Arnow-Richman, *Dilution of Employee Bargaining Power*, *supra* note 2, at 992. Many employment law scholars have suggested various doctrinal fixes. *See, e.g.*, KATHERINE V.W. STONE, FROM WIDGETS TO DIGITS: EMPLOYMENT REGULATION FOR THE CHANGING WORKPLACE 156 (2004) (arguing that courts should "limit enforcement of noncompete covenants to the protection of trade secrets narrowly defined"); Arnow-Richman, *Dilution of Employee Bargaining Power*, *supra* note 2, at 984 (suggesting doctrinal changes that would "encourag[e] disclosure on the front end of the employment relationship by refusing enforcement of cubewrap terms and

2. Noncompetes Restrict Employee Mobility and the Free Flow of Labor

At the risk of stating the obvious, noncompetes are problematic because they restrict employee mobility, both in theory and in practice.[62] At its extreme, a noncompetition agreement would violate the Thirteenth Amendment. That is, a complete restriction on post-employment labor is tantamount to involuntary servitude.[63] It goes without saying that such an agreement violates public policy concerning slavery, the alienability of labor, and "the right to quit."[64]

Given this background, even moderate restraints on post-employment activity have been viewed with suspicion.[65] Although employee noncompetes are enforceable in many states,[66] American statutory and common law evolved from this historical perspective, which means that such agreements are examined more closely than

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discourag[e] overbroad agreements by refusing judicial redrafting"); Closius & Schaffer, *supra* note 52, at 548-49; Gillian Lester, *Restrictive Covenants, Employee Training, and the Limits of Transaction-Cost Analysis*, 76 IND. L.J. 49, 72-74 (2001) (considering various alternative approaches); Sterk, *supra* note 33, at 387 (arguing that all noncompetes, not just "reasonable" noncompetes, ought to be enforceable); Sullivan, *supra* note 27, at 1177 (arguing against "blue-penciling" but admitting that the solution "has its limits"); *see also* Katherine V.W. Stone, *The New Psychological Contract: Implications of the Changing Workplace for Labor and Employment Law*, 48 UCLA L. REV. 519, 577-80 (2001) (critiquing noncompete doctrine, particularly as applied in a very mobile economy with limited employment security).

62. Even those who advocate for the enforcement of noncompetes would concede that this is a concern, and the current doctrinal approach in the states acknowledges it is a concern. *See supra* notes 49-50 and accompanying text.

63. *See* Blake, *supra* note 50, at 650.

64. Estlund, *Between Rights*, *supra* note 20, at 408 ("An extremely broad waiver of the right to work elsewhere after quitting, such as would be permitted under an ordinary contractual treatment of [noncompete] agreements, comes very close in effect to contracting away one's inalienable right to quit. So the pall of the Thirteenth Amendment and its ban on involuntary servitude hangs over these agreements."); *see also* Oren Bar-Gill & Gideon Parchomovsky, *Law and the Boundaries of Technology-Intensive Firms*, 157 U. PA. L. REV. 1649, 1667 (2009) ("Of course, the reach of these contractual restrictions and, correspondingly, the extent of control that they provide are not unlimited. And it is the law that sets the limits—limits that echo the slavery concerns raised by Hart." (citing OLIVER HART, FIRMS, CONTRACTS, AND FINANCIAL STRUCTURE 29 (1995))).

65. Sterk, *supra* note 33, at 411 ("When courts express hostility to restrictive covenants in employment agreements on involuntary servitude grounds, they suggest in effect that the right to choose how to use one's 'own' human capital is an important element of personal freedom."). *See generally* Blake, *supra* note 50, at 629-37 (discussing the common law's suspicion of restraints on trade).

66. Noncompetes are unenforceable in a few states, including California. *See* CAL. BUS. & PROF. CODE § 16600 (West 2008).

most other commercial agreements.[67] Even in the most permissive states, noncompetes are unenforceable if they prevent an employee from making a living or engaging in his or her profession of choice entirely. To be enforceable, a noncompete must be limited in geographic scope, temporal scope, and in restrictions on future employment.[68] In many jurisdictions, noncompetes must be supported by consideration so that in theory the employee receives some kind of benefit.[69] Functionally, however, noncompetes operate unilaterally in that the employee is burdened by postemployment restrictions, but the employer may fire the employee at any time (assuming at-will employment) and is not required to pay the employee during the restricted period.[70]

Noncompetes are certainly intended to restrict employee mobility. An agreement may state, for example, that the employee

> will not, during the period of [her] employment by the Company and in the event that [her] employment with the Company is terminated for any reason whatsoever and whether such termination be voluntary or involuntary, for a period of three

67. *See* Sterk, *supra* note 33, at 395 ("For centuries, English and American courts have carefully scrutinized restrictive covenants between employers and employees as 'restraints on trade.'"). In the majority of states, the approach varies in its details but is generally consistent. By the common law or by statute, many states apply a "rule of reason" in which the employee's interest in being free of the restriction is balanced against the employer's "protectable interest." The "public interest" is also often part of the calculation. *See supra* notes 19-20 and accompanying text.

68. *See, e.g.*, TEX. BUS. & COM. CODE ANN. § 15.50 (Vernon 2009) ("[A] covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee.").

69. The law in many states is in flux on this point. In some jurisdictions, at-will employment, or continued at-will employment, is deemed sufficient consideration, but in other states, the law requires some additional consideration. *See, e.g.*, Lucht's Concrete Pumping, Inc. v. Horner, 224 P.3d 355, 359 (Colo. App. 2009) ("We are persuaded by the rationale in these cases and in others that have similarly held that continued employment does not create consideration for a noncompete agreement once an employee has begun working for an employer."), *cert. granted*, No. 095C627, 2010 WL 341383 (Colo. Feb. 1, 2010).

70. In England, noncompetes are enforceable, but the employer must pay the employee during the postemployment restricted period. This is called "gardening leave." Arnow-Richman, *Delayed Term*, *supra* note 45, at 663 n.118.

> years (3) following such termination, (i) directly or indirectly engage in any competitive business.[71]

This agreement seeks to limit, though not eliminate, the employee's ability to terminate her employment and secure another job.[72] It seems obvious that—all things being equal—it is in the employee's interest to be free of such restrictions.

The actual effects of the agreement on the individual employee will likely vary. The employee may not have read or understood the agreement, and it may, for that reason, have no effect whatsoever on the employee's behavior. In contrast, if the employee has read the agreement or is otherwise aware of the noncompete, the agreement may make it more likely that the employee will stay with the employer, rather than leave to take advantage of other opportunities. This, of course, is precisely the point of a noncompete from the employer's perspective: retaining the employee and the investment the employer has made in that employee while, at the same time, preventing a competitor from gaining access to the skills, knowledge, or information possessed by the employee. One recent empirical study supports the intuition that noncompetes do in fact have the effect of increasing employee retention by deterring employees from departing. It concludes that "workers subject to non-competes [tend] to stay with their employers."[73] This is one way, then, in which noncompetes limit employee mobility.

Noncompetes may affect employee mobility in other ways. If an employee decides, notwithstanding the noncompete, to terminate

71. Sample Agreement, *supra* note 38.

72. Sterk describes this situation as the epitome of the alienability of labor, and he views it as a good thing, arguing that virtually all noncompetes—not just "reasonable" noncompetes—ought to be enforceable. Sterk, *supra* note 33, at 412 ("These restrictions on a person's ability to alienate his own human capital have been justified in part by the need to discourage anticompetitive behavior, in part by the need to protect employees from the greater bargaining power of employers, and, most significantly, by the need to protect individual freedom. None of those justifications, however, is entirely persuasive.").

73. Matt Marx, Good Work If You Can Get It ... Again: Noncompete Agreements, "Occupational Detours," and Attainment 3 (Aug. 17, 2009) (unpublished manuscript), http://ssrn.com/abstract=1456748 [hereinafter Marx, Good Work]; *see also* Bruce Fallick, Charles A. Fleischman & James B. Rebitzer, *Job-Hopping in Silicon Valley: Some Evidence Concerning the Microfoundations of a High-Technology Cluster*, 88 REV. ECON. & STAT. 472, 481 (2006) ("Our finding of a California effect on mobility lends support to Gilson's hypothesis that the unenforceability of noncompete agreements under California state law enhances mobility and agglomeration economies in IT clusters.").

her employment with an employer, or if an employee is fired or laid off,[74] such an employee may seek employment that conflicts with the terms of the agreement, risking a lawsuit, or she may accept employment in another field to avoid breaching the agreement. Professor Matt Marx's study concludes that these possibilities are real. Workers subject to noncompetes often take "occupational detours," which may not redound to their benefit.[75] The "results suggest that those who change jobs while subject to non-competes may actually be taking a step backward in their careers."[76] The implications of Marx's study are significant. "Not only do non-competes discourage individuals from changing jobs to take advantage of attractive opportunities; when workers subject to non-competes nonetheless leave their jobs, their next step often becomes decidedly unattractive: working surreptitiously within their field, leaving their field, or not working at all."[77]

Moreover, studies have demonstrated not only the individual effects of noncompetes but also the effect on the flow of labor in particular markets. In a fascinating study involving Michigan law on noncompetes, Matt Marx, Deborah Strumsky, and Lee Fleming concluded that employee mobility is in fact tied to the rule concerning the enforceability of noncompetes.[78] Michigan created a perfect setting for a study of the effects of the legal rule concerning noncompetes:[79] the state legislature inadvertently (strange but true, apparently) changed the rule on noncompetes.[80] They were unenforceable

74. Note that in the illustrative agreement the postemployment restrictions are in force regardless of the reason the employment relationship terminated. *See* Sample Agreement, *supra* note 38.

75. Marx, Good Work, *supra* note 73, at 3.

76. *Id.* at 4. Marx concludes that "[k]nowledge workers subject to non-competes find it difficult to continue in their chosen profession when changing jobs, often leaving their field." *Id.* at 44.

77. *Id.* at 46 (citation omitted).

78. Marx, Strumsky & Fleming, *supra* note 44, at 876.

79. *Id.* at 878 ("Michigan is the only state we know to have clearly and inadvertently reversed its enforcement policy in the past century. Given that Michigan's shift in non-compete enforcement appears to have been exogenous, we propose that Michigan affords a 'natural experiment' with which to directly test the impact of non-competes on worker mobility.").

80. In 1985, the legislature passed the Michigan Antitrust Reform Act, which repealed a large section of the state's code, including the provision holding noncompetes unenforceable. The abolition of that provision was apparently not the purpose of the statutory repeal and was, evidently, neither intentional nor even noticed at the time. *See id.* at 877 ("Given that the impetus for the change in law appears to have been general antitrust reform and not

before 1985[81] but became enforceable thereafter.[82] Drawing on information in patent applications, the researchers found that "[t]he job mobility of inventors in Michigan fell 8.1% following the policy reversal compared to inventors in other states that continued to proscribe non-competes, and these effects were amplified for those with particular characteristics."[83] Other studies have documented similar effects.[84] Noncompetes are undoubtedly intended to restrict the free flow of the labor market, and based on recent empirical work, it appears that they achieve this goal.

Generally speaking, then, noncompetes are at odds with both the fair bargaining process and efficiency underpinnings of the freedom of contract rationale.[85] Unlike the vast majority of contracts that are consistent with and promote market exchange—and thus efficiency—noncompetes also operate as interventions in the market. By their very terms, they seek to reduce competition in the market for labor, and it appears that they do have that effect.[86] In short, they represent a fairly radical departure from the neoclassical model of contract formation on which the freedom of contract principle is based.

Based on these critiques, many scholars have argued for doctrinal reforms of various sorts, though few, if any, have proposed a simple

specifically altering non-compete enforcement, it appears that the 1905 statute prohibiting non-competes was inadvertently repealed as part of the antitrust reform.").

81. MICH. COMP. LAWS ANN. § 445.761 (West 1967) ("All agreements and contracts by which any person ... agrees not to engage in any avocation [or] employment ... are hereby declared to be against public policy and illegal and void.").

82. The provision prohibiting the enforcement of noncompetes was repealed, and lawyers and employers in Michigan soon realized that they could impose such terms on employees. Marx, Strumsky & Fleming, *supra* note 44, at 877-78.

83. *Id.* at 876 ("Michigan inventors with skills one standard deviation above the mean in their firm-specificity experienced a decrease in their job mobility of 15.4%.").

84. Fallick, Fleischman & Rebitzer, *supra* note 73, at 481 ("Our finding of a California effect on mobility lends support to Gilson's hypothesis that the unenforceability of noncompete agreements under California state law enhances mobility and agglomeration economies in IT clusters."). For a discussion of Gilson's argument, see *infra* notes 173-81 and accompanying text.

85. *See* Arnow-Richman, *Delayed Term*, *supra* note 45, at 639. "The proliferation of cubewrap contracts poses a significant challenge to those who might otherwise support private ordering in setting and policing the terms of employment relationships." *Id.* at 641 (arguing for mandatory disclosure of standard-form employment agreements).

86. *See, e.g.*, Estlund, *Between Rights*, *supra* note 20, at 411-12 ("Non-compete agreements obviously stifle competition; they run into the venerable public policy against contracts in restraint of trade.").

rule of unenforceability. This is understandable, perhaps, given the general force of the freedom of contract rationale; contract law doctrine does not generally allow for the possibility of making classes or types of contracts unenforceable.[87]

Viewing the issue through a broader lens, however, and using that perspective to reevaluate the use and enforceability of noncompetes, it becomes clear that doctrinal fixes are insufficient to address the problems created by noncompetes. Instead, they should simply be unenforceable.

II. THE FAILURE OF THE IP JUSTIFICATION

Although many scholars have persuasively critiqued the use of noncompetes as a problematic aspect of the employment relationship, few have acknowledged or addressed the most common argument proffered for noncompetes, the IP justification.[88] A thorough reexamination of noncompetes is incomplete without this perspective. Upon closer examination, it becomes clear that firms use noncompetes as tools for protecting IP. So understood, noncompetes must be evaluated by the metrics of IP protection, and applying those criteria, the IP justification fails. Noncompetes are simply the wrong tool for the IP job.

In this Part, I first demonstrate the ubiquity of the IP justification for noncompetes and summarize the general purposes and goals of IP protection. Based on that background, I then argue that noncompetes fail to serve—and indeed conflict with—these purposes and goals.

The IP justification fails because noncompetes are simply not a good tool for protecting intangible assets.[89] Moreover, permitting their use interferes with the goals of the IP regimes. A refusal to enforce the agreements would better serve the purposes of providing IP protection by channeling efforts to protect intangibles to the IP regimes. To countenance noncompetes permits firms an end run

87. *But see* Sullivan, *supra* note 27, at 1131 & n.16.

88. IP scholars have assumed that noncompetes operate as a form of IP protection, but few, if any, have challenged the justification. *See, e.g.*, Bar-Gill & Parchomovsky, *supra* note 64, at 1655 (discussing covenants not to compete as a "nonproperty source of control" over IP); Jonathan M. Barnett, *Is Intellectual Property Trivial?*, 157 U. PA. L. REV. 1691, 1706 (2009) (discussing noncompetes as an alternative method of IP protection).

89. *See infra* Part II.B.

around the requirements of the IP regimes without the tradeoffs those regimes entail. In addition, even if additional forms of protection are needed, noncompetition agreements fail to serve the policy goals of IP protection.

A. The Misplaced IP Justification for Noncompetes

Firms and courts regularly justify noncompetes with the asserted need to protect IP or IP-like assets, but this use of noncompetes has escaped the attention of many scholars.[90] The IP justification is often explicit: noncompetes are necessary to protect a firm's trade secrets, for example. Even when it is not explicit, the IP justification emerges implicitly when proponents argue that noncompetes are necessary to encourage invention, disclosure, and investment in employees. Employers and courts also put forth a more general argument about the "business necessity" served by noncompetes, contending that they are necessary to protect the employer's legitimate interests.[91] This argument, upon closer examination, is merely another iteration of the IP justification. In Part II.A.1, I elaborate on this point, making clear the regularity with which the IP justification is proffered. I then briefly describe the purposes and goals of the IP regimes, because, to the extent that noncompetes are used as tools for protecting IP, they must be evaluated in light of those purposes and goals.

1. The IP Justification for Noncompetes

There are at least two versions of the IP justification. Sometimes the justification is explicit: firms or courts will assert that noncompetes are necessary to protect trade secrets or other intangible assets.[92] Other times, the argument is implicit or attenuated, but

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90. *But see* Rachel S. Arnow-Richman, *Bargaining for Loyalty in the Information Age: A Reconsideration of the Role of Substantive Fairness in Enforcing Employee Noncompetes*, 80 OR. L. REV. 1163, 1182-85 (2001) [hereinafter Arnow-Richman, *Bargaining for Loyalty*].

91. *See, e.g.*, *id.*

92. *See* Katherine V.W. Stone, *Knowledge at Work: Disputes Over the Ownership of Human Capital in the Changing Workplace*, 34 CONN. L. REV. 721, 746 (2002) [hereinafter Stone, *Knowledge at Work*] ("A court will not enforce a covenant if it is solely a means to restrain trade. Rather, the long-standing view has been that to be enforceable, a covenant not to compete must protect an employer's interest in a trade secret or in other 'confidential information.'").

should be understood as another version of the IP justification. In either case, upon closer examination, it becomes obvious that noncompetes are primarily used to protect IP or IP-like assets.

The explicit IP justification is regularly cited and appears to be widely accepted and generally uncontroversial. It is often asserted that noncompetes are necessary for the protection of trade secrets and other forms of IP.[93] Noncompete agreements regularly cite trade secrets or confidential information as the "protectable interest" sought to be guarded with the contract.[94] An agreement may state, for example: "I understand that this Section ... is not meant to prevent me from earning a living or fostering my career. It does intend, however, to prevent any competitive business from gaining any unfair advantage from my *knowledge of Proprietary Information*."[95] Proprietary information is often defined quite broadly, but generally refers to IP or IP-like intangibles.[96]

Courts regularly justify noncompetes by reference to the need to protect trade secrets.[97] State law sometimes makes the connection explicit. Colorado law, for example, provides that noncompetes are unenforceable except in a few circumstances, one of which is a contract for the purpose of protecting trade secrets.[98] In California, notwithstanding a recent ruling reaffirming the state's prohibition

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93. Although there is some dispute, trade secrets are generally deemed to be a form of IP. On the varying descriptions of and justifications for trade secret law, see Mark A. Lemley, *The Surprising Virtues of Treating Trade Secrets as IP Rights*, 61 STAN. L. REV. 311, 319-29 (2008) [hereinafter Lemley, *Surprising Virtues*]. Lemley argues "that trade secrets are best conceived as IP rights, and that, as IP rights, they work—they serve the basic purposes of IP laws." *Id.* at 329; *see also* Bar-Gill & Parchomovsky, *supra* note 64, at 1676 ("Despite their weak proprietary status, the protection afforded to trade secrets is broad and strong.").

94. Nolo, *Noncompete Agreements: How To Create an Agreement You Can Enforce*, http://www.nolo.com/legal-encyclopedia/article-29784.html (last visited Nov. 12, 2010) ("Use a noncompete agreement to prevent losing valuable trade secrets and employees.").

95. Sample Agreement, *supra* note 38 (emphasis added). Note that this agreement acknowledges the tensions created by noncompetes and asserts that it is not intended to be overly restrictive.

96. *See id.*

97. *See, e.g.*, Comprehensive Techs. Int'l, Inc. v. Software Artisans, Inc., 3 F.3d 730, 739 (4th Cir. 1993) ("When an employee has access to confidential and trade secret information crucial to the success of the employer's business, the employer has a strong interest in enforcing a covenant not to compete because other legal remedies often prove inadequate."); *see also* Arnow-Richman, *Bargaining for Loyalty*, *supra* note 90, at 1184-85.

98. COLO. REV. STAT. § 8-2-113 (2009) (stating that noncompetes for the purpose of protecting trade secrets may be enforceable).

on noncompetes,[99] firms continue to assert that such agreements are necessary to protect their trade secrets and that a common law "trade secrets" exception applies to the California rule.[100] And commentators agree that employers generally use noncompetes to protect IP or IP-like assets.[101]

The Fourth Circuit provides a classic example in its opinion in *Comprehensive Technologies International, Inc. v. Software Artisans, Inc.*[102] In that case, Comprehensive Technologies International (CTI) sued a former employee, Dean Hawkes, for copyright infringement, trade secret misappropriation, and breach of a noncompete, among other claims.[103] The Fourth Circuit upheld the trial court's rejection of the copyright claim[104] and the trade secret claim[105] on the grounds that there were no trade secrets and, even if there were, that they were not misappropriated. The court permitted CTI to pursue its noncompete claim, however, stating that the noncompete was necessary in order to protect CTI's trade secrets and other confidential information.[106] In other words, the court accepted the IP

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99. *See* Edwards v. Arthur Andersen L.L.P., 189 P.3d 285, 293 (Cal. 2008).

100. *See, e.g.*, Dowell v. Biosense Webster, Inc., 102 Cal. Rptr. 3d 1, 11 (Ct. App. 2009) ("Biosense argues that the [noncompete] clauses in the agreements are narrowly tailored to protect trade secrets and confidential information because they are 'tethered' to the use of confidential information, and are triggered only when the former employee's services for a competitor implicate the use of confidential information."). It should be noted that the noncompete agreements signed by these California employees contained New Jersey choice of law and consent-to-venue clauses. *Id.* at 4. The court did not address these provisions or explain why it was applying California law.

101. Arnow-Richman, *Delayed Term*, *supra* note 45, at 638-39 (concluding that employers regularly use standard-form agreements for, among other reasons, "augmenting their trade secret rights"); *see also* Estlund, *Between Rights*, *supra* note 20, at 416 ("Some noncompetes—those that protect employers' trade secrets—may thus be justified as necessary to protect independently recognized employer rights."); Michael V. Risch, *Economic Analysis of Labor and Employment Law in the New Economy: Proceedings of the 2008 Annual Meeting, Association of American Law Schools, Section on Law and Economics*, 12 EMP. RTS. & EMP. POL'Y J. 339, 340 n.43 (2008).

102. 3 F.3d 730 (4th Cir. 1993) (rejecting the employer's trade secrets claim because of a lack of trade secrets but upholding the noncompete on the basis of protecting trade secrets and other confidential information). I call this a classic example because it is one that has been used regularly in discussions of noncompetes. *See, e.g.*, ROBERT P. MERGES, PETER S. MENELL & MARK A. LEMLEY, INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 96 (5th ed. 2010); Arnow-Richman, *Bargaining for Loyalty*, *supra* note 90, at 1184-85.

103. *Software Artisans, Inc.*, 3 F.3d at 732.

104. *Id.* at 735.

105. *Id.* at 737.

106. *Id.* at 739 ("When an employee has access to confidential and trade secret information crucial to the success of the employer's business, the employer has a strong interest in

justification despite concluding that the employer did not prevail on either IP claim! Thus, the IP justification may carry the day even when untethered from trade secret or other IP rights.

A common corollary to the form of the IP justification discussed above is that trade secret law on its own is too limited and thus insufficient to protect the employer's information.[107] In other words, the assumption is that it is easier to prevent an employee from working for Company X than it is to ensure that particular kinds of information will not be leaked from the employee's head to the new employer.[108] Employers thus use noncompetes in part "to provide an extra layer of protection."[109] For example, attorneys often advise clients to use noncompetes to "identify and correct potential holes in their trade secrets protection strategies."[110] A World Intellectual Property Organization commentary on "Trade Secrets and Employee Loyalty" has a subsection titled "Employees are the Biggest Threat" and suggests that contracts, including noncompetes, may be desir-

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enforcing a covenant not to compete because other legal remedies often prove inadequate.... On the facts of this case, we conclude that the scope of the employment restrictions is no broader than necessary to protect CTI's legitimate business interests.").

107. Arnow-Richman, *Dilution of Employee Bargaining Power*, *supra* note 2, at 983 n.71 ("Indeed, it is widely assumed by lawyers that [noncompetes] can provide additional protection for intellectual property interests beyond what is afforded under common law."); *see, e.g.*, Stone, *Knowledge at Work*, *supra* note 92, at 747 ("The historical link between noncompete covenants and trade secrets is somewhat paradoxical because disclosure of trade secrets and confidential information can be restrained in the absence of a covenant. However, it has been argued that, for procedural reasons, it is difficult to obtain enforcement of a trade secret, so that a restrictive covenant provides employers with important additional protection.").

108. Risch, *supra* note 101, at 340 n.43 (explaining that with trade secret law, "[e]mployers must prove that ex-employees misappropriated information, ... which is more difficult than simply proving that they are competing").

109. Estlund, *Between Rights*, *supra* note 20, at 416.

110. Seyfarth Shaw, http://www.seyfarth.com/index.cfm/fuseaction/practice_area.practice_area/practice_area.cfm (follow "Trade Secrets, Computer Fraud & Non-Competes" hyperlink) (last visited Nov. 12, 2010) (listing four strategies to compensate for the "holes" in trade secret protection); *see also* Frost Brown Todd, http://www.fbtemployerlaw.com/lande/ncts/NewsDetail.aspx?newsShortId=355 (last visited Nov. 12, 2010) (indicating that noncompetes may be the "best of all worlds" for a variety of reasons, including that other methods of protection, including nondisclosure agreements, do not prevent "competitive damage" from occurring). One Minnesota attorney stated with respect to noncompetes, "The nature of the modern economy means companies have to be service-oriented and idea-oriented, and many smaller companies are seeing the need to protect those ideas any way they can." Dan Heilman, Noncompetes Have Teeth in Minnesota 2 (May 7, 2007), http://laurielaurie.com/noncompetes1.pdf.

able because they "enhance legal protection of trade secrets."[111] That is, noncompetes are justified on the need to protect trade secrets *and* on the need to protect things that are not trade secrets.

Even when the IP justification is not explicit, it is often implicit. Many justifications for noncompetes are not framed in terms of IP protection, but they involve efforts to protect "confidential information," "investments in human capital," "proprietary information," and the like. Proponents of noncompetes, courts and lawyers alike, justify noncompetes with general references to "legitimate business interests," "business necessity," and the need to prevent "unfair competition," often without more.[112] Moreover, many argue that noncompetition agreements are necessary to provide firms an incentive to invest in the training of employees and to encourage disclosure of information to employees that increases the efficiency and productivity of the firm. Professor Sterk, for example, argues that noncompete enforcement is necessary to "assur[e] that em-

111. Talhiya Sheikh, Trade Secrets and Employee Loyalty, http://www.wipo.int/sme/en/documents/trade_secrets_employee_loyalty.html (last visited Nov. 12, 2010).

112. Although in the majority of cases these claims about business necessity are likely made in good faith, we ought to be suspicious of imposing restrictions on employee mobility based on such conclusory assertions. That is, if in fact there is no business necessity or legitimate interest, a noncompetition agreement ought not to be countenanced. Indeed, the balancing tests, used by many states to evaluate noncompetes, contemplate some proof of the employer's legitimate interest in imposing the noncompete. As a practical matter, however, it appears that in many litigated cases there is little, if any, evidence presented concerning the actual scope and nature of the employer's interest. Discussing *Comprehensive Technologies International v. Software Artisans*, Rachel Arnow-Richman stated,

> Having dismissed the trade secret claim, however, the court went on to conclude that the employer had demonstrated a legitimate interest in confidential information justifying enforcement of the employee's noncompete.
>
> ... The only additional explanation or source proffered in the opinion to support this generalized conclusion was the fact that the employment agreement containing the noncompete recited that the employee would have access to confidential and secret information.
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> Such rote conclusions are typical of many cases involving the assertion of confidential information as a protectable interest.

Arnow-Richman, *Bargaining for Loyalty*, *supra* note 90, at 1184-85. More importantly, perhaps, the vast majority of noncompetes are not litigated and subjected to the requirement of proof. There is thus little incentive for employers to carefully evaluate the "business necessities" motivating the use of the noncompete agreement as it will never be held to proof in court. To the extent that courts do not often require much specificity, the incentive is accordingly reduced even further. We should thus expect that noncompetes are used more than is necessary—assuming they are necessary at all, a point I do not concede—and that they are overbroad in their operation.

ployees acquire optimal levels of information and client contact."[113] Boiled down, these various formulations all refer to intangible assets—as opposed to the tangible assets of a firm, such as computers and factories—and it is intangibles that the IP regimes are designed to address. In addition, the incentive arguments are classic justifications for the grant of IP rights.

2. Intellectual Property Policy

Given that both state and federal law provide a variety of mechanisms for protecting intangibles, the IP justification for noncompetes deserves close scrutiny. And to evaluate this justification, we must turn to IP law. Only by looking to the current scope of protection and the purposes of IP law can we determine whether and to what extent the IP justification for noncompetes is persuasive.

Because the most common form of the IP justification refers to the limitations of trade secret law, I focus on that field here. However, firms' IP and IP-like assets may be protected in a variety of ways, and employers have a number of legal mechanisms to protect their intangibles. Trade secrets are protected through a separate body of law: the Uniform Trade Secrets Act has been adopted by forty-five states, the District of Columbia, and the U.S. Virgin Islands,[114] and operates generally to provide penalties for the misappropriation of trade secrets, as defined by the Act.[115] Federal patent and copyright

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113. Sterk, *supra* note 33, at 394 ("Long-term contracts, enforceable by restrictive injunction, provide a mechanism for insuring against such losses and thus for assuring that employees acquire optimal levels of information and client contact."); *see, e.g.*, Paul H. Rubin & Peter Shedd, *Human Capital and Covenants Not To Compete*, 10 J. LEGAL STUD. 93, 93 (1981) ("In particular, restrictive covenants were and are necessary in some circumstances to lead to efficient amounts of investment in human capital."). This argument focuses on the enforcement of and remedies for breach of employment contracts. It is unclear, however, that employers are interested in entering into long-term employment contracts with many employees; most employment in the United States is at will. It is of course possible that long-term contracts encourage optimal investment in employees and optimal disclosure of information to employees. I am not certain, however, that the argument translates to noncompetes.

114. Uniform Law Commissioners, A Few Facts About the Uniform Trade Secrets Act, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-utsa.asp (last visited Nov. 12, 2010).

115. *See* UNIF. TRADE SECRETS ACT §§ 1-4 (1985).

statutes provide more robust protection for inventions and creations.[116]

In addition to the statutory protections, common law duties offer employers legal protection for their intangible assets. Employees generally have common law duties of confidentiality and loyalty;[117] even if information is not deemed a trade secret, an employee may not disclose confidential information of the employer.[118] Because of fiduciary and agency responsibilities, employees may not compete with their employers during the term of employment, though they may prepare to compete while employed and then compete following termination of the employment relationship (in the absence of a noncompete, of course).[119] Moreover, a variety of contractual mechanisms are available to reinforce these common law duties: nondisclosure and confidentiality agreements are widely used and unquestionably enforceable.[120] Even with this briefest of overviews, it should be clear that employers are not without legal mechanisms for protecting their intangible assets and protecting against "unfair competition" from former employees.[121] This fact must be taken into account in considering the IP justification for noncompetes.

The primary justifications for granting IP rights are the desire to provide an incentive to invent and create, and an incentive to disclose those inventions and creations.[122] The conferral of IP rights by the state is deemed necessary because intellectual assets are public goods; once they are disclosed they are nonrivalrous and nonexcludable. That is, anyone may use intangibles without

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116. *See, e.g.*, Bar-Gill & Parchomovsky, *supra* note 64, at 1671-81 (discussing the role of patent law and copyright law in promoting and governing innovation).

117. RESTATEMENT (SECOND) OF AGENCY § 387 cmt. b (1958).

118. *Id.* § 387 cmt. d.

119. Jet Courier Serv., Inc. v. Mulei, 771 P.2d 486, 492-93 (Colo. 1989).

120. *See, e.g.*, IDX Sys. Corp. v. Epic Sys. Corp., 285 F.3d 581, 585 (2002) (holding that the reasons for limiting enforcement of noncompetes do not apply to confidentiality agreements).

121. The law generally attempts to distinguish between "fair" and "unfair" competition. The cases distinguishing "preparing to compete" from "competing," for example, seek to draw that line. *See generally* Scott W. Fielding, *Free Competition or Corporate Theft?: The Need for Courts To Consider the Employment Relationship in Preliminary Steps Disputes*, 52 VAND. L. REV. 201, 206-07 (1999); Sullivan, *supra* note 27, at 1148-49 ("While the law ... recognizes legitimate reasons for an employer to seek protection from competition from former [employees], the limitations it imposes reflect a countervailing recognition that illegitimate employer interests may also be served by noncompetition agreements.").

122. Lemley, *Surprising Virtues*, *supra* note 93, at 329 (stating that IP rights "promote inventive activity and they promote disclosure of those inventions").

affecting anyone else's enjoyment of them, and access to them is difficult if not impossible to restrict.[123] Because of these characteristics, the concern is that in the absence of legal protection, insufficient investment will be made in the creation or invention of intangibles.[124] Thus the grant of property-like rights is thought necessary to encourage creation of those "goods."[125] This protection is expressly utilitarian: rights are granted to the extent that the benefits exceed the costs.[126] The utilitarian approach entails an attempt to confer only the type and strength of rights sufficient to encourage invention or creation, and dissemination, but no more.[127]

For example, in the absence of patent rights, we would be concerned that companies or individuals would not invest in the research and development that leads to innovation, and we would be concerned that the innovations would not be disclosed to the public. Thus we grant a patent right, even though it is a form of monopoly, to encourage the invention and its disclosure to the public.[128] Patent rights are relatively strong, providing a right to

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123. *See* MERGES, MENELL & LEMLEY, *supra* note 102, at 12-14 (discussing nonexcludability and nonrivalrousness).

124. *See* Lemley, *Surprising Virtues, supra* note 93, at 329 ("[P]atents and copyrights are generally acknowledged to serve a utilitarian purpose—the grant of legal control encourages the development of new and valuable information by offering the prospect of supracompetitive returns, returns possible only if the developer does not face competition by others who use the same idea. In this way, patents and copyrights avoid the risk of underinvestment inherent with public goods, which are more costly to invent than to imitate once invented."). For a more in-depth discussion of this issue, see Mark A. Lemley, *The Economics of Improvement in Intellectual Property Law*, 75 TEX. L. REV. 989, 993-1000 (1997).

125. Dan L. Burk & Brett H. McDonnell, *The Goldilocks Hypothesis: Balancing Intellectual Property Rights at the Boundary of the Firm*, 2007 U. ILL. L. REV. 575, 583 ("[P]rivate individuals will generally lack incentives to produce an adequate level of public goods. A key point of intellectual property is to help lessen the public good nature of new ideas by giving creators the ability to legally exclude others from using the ideas.").

126. *See* Barnett, *supra* note 88, at 1699-1700 ("Virtually all students learn, many academic commentaries repeat, and countless judicial opinions state that stronger or weaker intellectual property always involves an unavoidable tradeoff between increasing innovation incentives (and resulting innovation gains), which result from stronger intellectual property, and reducing access costs, which result from weaker intellectual property.").

127. *See, e.g.*, Burk & McDonnell, *supra* note 125, at 577 (considering a variety of forms of IP protection and arguing "that intellectual property rights that are improperly calibrated, that are either too strong or too weak, will lead to inefficient firm and market structures"); *see also* Andrea Fosfuri & Thomas Rønde, *High-Tech Clusters, Technology Spillovers, and Trade Secret Laws*, 22 INT'L J. INDUS. ORG. 45 (2004) (concluding that "trade secret protection based on punitive damages, except in some extreme cases, is beneficial for firms' profits, stimulates clustering, and is not an impediment to workers' mobility").

128. *See* Graham v. John Deere Co., 383 U.S. 1, 9 (1966) (noting Thomas Jefferson's

exclude for twenty years[129] in exchange for disclosure to the public[130] and the injection of the invention into the public domain once the patent term expires. Similarly, copyright law involves an effort to encourage the creation and dissemination of original expression, providing a long term of protection but also a number of exceptions and defenses that allow for various kinds of public uses.[131] Trade secret protection is a creature of state law, and it often operates as an alternative or a supplement to the federal protections for intangibles, protecting all kinds of "valuable" and "secret" information.[132] As with copyright and patent law, it is generally animated by a utilitarian philosophy; it is thought that trade secret protection is necessary to provide a further incentive for innovation.[133]

Broadly speaking, patent, copyright, and trade secret law each have their own internal balancing mechanisms—the strength of the rights granted versus the number and type of defenses, for example. Professor Jonathan Barnett describes the conventional wisdom concerning this utilitarian approach:

> This tradeoff assumes that more intellectual property generates social harm by reducing access to intellectual goods, but generates social benefits by enhancing anticipated profits and thereby enhancing innovation incentives. Conversely, less intellectual property generates social benefits by expanding access to intellectual goods but generates social harm by reducing anticipated profits and thereby reducing innovation incentives. Hence, the policy challenge lies in setting intellectual property coverage so as always to yield a net social gain.[134]

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recognition of the difficulty of "drawing a line between the things which are worth to the public the embarrassment of an exclusive patent, and those which are not" (quoting Letter from Thomas Jefferson to Isaac McPherson (Aug. 13, 1813), *reprinted in* 6 WRITINGS OF THOMAS JEFFERSON 181 (H.A. Washington ed., John C. Riker 1857))).

129. 35 U.S.C. § 154(a)(2) (2006).

130. *Id.* § 112.

131. *See* 17 U.S.C. § 107 (fair use); *id.* § 302 (duration of copyright).

132. UNIF. TRADE SECRETS ACT § 1(4)(i) (1985) (defining a trade secret as "information" that "derives independent economic value ... from not being generally known to, and not being readily ascertainable by proper means by, other persons"). On the differing and inconsistent justifications for trade secret law, see Lemley, *Surprising Virtues*, *supra* note 93, at 331 ("[T]he additional incentive provided by trade secret law is important for innovation.").

133. Lemley, *Surprising Virtues*, *supra* note 93, at 319.

134. Barnett, *supra* note 88, at 1693-94 (describing the standard explanation for the conferral of IP rights). Barnett argues, however, that IP rights do not tell the whole story. Instead, to understand and evaluate the IP regimes, one must look to nonproperty forms of

Some argue for stronger IP rights, whereas others contend that we have gone too far in terms of patent rights or copyright protection, for example.[135] The proper balance within each of the IP regimes is, of course, a matter of great dispute, but few would disagree that the IP regimes seek to find this balance.[136]

It is also generally understood that the IP regimes do not operate in isolation.[137] Rather, the protections provided by each must be understood in terms of, and balanced against, the others. For example, and most pertinent here, some of the contours of trade secret law have developed and been interpreted by reference to other forms of IP protection.[138] Taking this view across the IP regimes, certain kinds of intangibles—valuable inventions that are self-disclosing, for example—are channeled to the patent system, which allows for public disclosure of inventions, among other things.[139] Other forms of legal protection may protect some inven-

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protection as well. *Id.* at 1693 ("[F]irms generally can—and *do*—exploit devices *other* than intellectual property to limit access to, and thereby appropriate returns from, innovation investments. Hence, intellectual goods that are unprotected by intellectual property may still be protected directly or indirectly by other legal or extralegal mechanisms, which broadly include technology, contract, organizational form, and various complementary assets.").

135. LAWRENCE LESSIG, FREE CULTURE: HOW BIG MEDIA USES TECHNOLOGY AND THE LAW TO LOCK DOWN CULTURE AND CONTROL CREATIVITY xvi (2004) ("But just as a free market is perverted if its property becomes feudal, so too can a free culture be queered by extremism in the property rights that define it. That is what I fear about our culture today. It is against that extremism that this book is written.").

136. Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 146 (1989) ("From their inception, the federal patent laws have embodied a careful balance between the need to promote innovation and the recognition that imitation and refinement through imitation are both necessary to invention itself and the very lifeblood of a competitive economy."); *see also* Burk & McDonnell, *supra* note 125, at 577 (positing a "'Goldilocks hypothesis' for intellectual property rights and the firm: like the size of a chair, the temperature of a porridge, or the firmness of a mattress, the provision of intellectual property rights should not vary too far to one extreme or another, but must be calibrated so that it is 'just right'"). For an argument that the balance should be shifted significantly in the direction of stronger rights, see, for example, Edmund W. Kitch, *The Nature and Function of the Patent System*, 20 J.L. & ECON. 265, 290 (1977) (advocating relatively strong patent rights: "defined property rights in information significantly lower the costs of transactions concerning such information").

137. *See* Viva R. Moffat, *Mutant Copyrights and Backdoor Patents: The Problem of Overlapping Intellectual Property Protection*, 19 BERKELEY TECH. L.J. 1473, 1512 (2004) (arguing that "overlapping protection disrupts the federal intellectual property system, frustrates the patent and copyright bargains, and meddles with the incentive structures").

138. *See infra* note 155.

139. *See* Lemley, *Surprising Virtues*, *supra* note 93, at 341 ("Taken together, the secrecy requirement and the relative weakness of the trade secret law help ensure that the law protects those who would otherwise rely on secrecy without law, and encourages disclosure

tions that are not patentable, but some may receive no protection at all, as a matter of public policy. For example, an invention that is not "novel" for the purposes of patent law is deemed part of the public domain and free for all to copy.[140]

The balancing between the IP regimes is most clear in cases discussing the relationship between trade secret law and patent law. In *Kewanee Oil Co. v. Bicron Corp.*, the Supreme Court held that federal patent law did not preempt Ohio's trade secret law,[141] emphasizing the narrowness of the state law.[142] If trade secret law was to provide more robust protection, for example, by prohibiting reverse engineering or protecting against independent invention, under the reasoning in *Kewanee* it would likely be preempted because it would be too similar to the protections provided by federal patent law. "The Court reasoned that there was 'remote' risk that holders of patentable inventions would choose trade secret protection because trade secret law provides far weaker protection than patent protection."[143] Some trade secret doctrines—in particular the rule permitting reverse engineering—thus serve a channeling function, directing some inventions to the patent regime, some to trade secret protection, and some to the public domain. In other

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in those cases, while not displacing patent law as the means of protection for self-disclosing inventions. Put another way, the secrecy requirement channels particular inventors to the form of IP protection that best achieves the goals of society."); *see also* MERGES, MENELL & LEMLEY, *supra* note 102, at 82 ("Reverse engineering may be explained as a legal rule designed to weaken trade secret protection relative to patent protection."). This is the theory, at least. It is an empirical question whether the weakness of state law actually propels inventors to the patent office. There is some reason to think that inventors may at times prefer trade secret protection even for patentable inventions. *See* Sharon K. Sandeen, Kewanee *Revisited: Returning to First Principles of Intellectual Property Law To Determine the Issue of Federal Preemption*, 12 MARQ. INTELL. PROP. L. REV. 299, 324 (2009).

140. *See, e.g.*, Aronson v. Quick Point Pencil Co., 440 U.S. 257, 257 (1979) (noting that one purpose of the patent system is "to assure that ideas in the public domain remain there for the free use of the public").

141. 416 U.S. 470, 492 (1974).

142. The Court pointed out that Ohio's trade secret statute provided a cause of action only when there had been improper use of the trade secret under circumstances in which a duty existed not to so misuse the trade secret. *Id.* at 475-76. The Court also discussed the various circumstances in which discovery of a trade secret does not constitute misappropriation: independent invention, accidental disclosure, and reverse engineering. *Id.* at 476. The Court relied on the very weakness of trade secret law in determining that it could coexist with federal patent law. *Id.* at 489-90. For a thorough discussion of *Kewanee* and the relationship between state trade secret law and federal patent law, see Sandeen, *supra* note 139, at 324-25.

143. Sandeen, *supra* note 139, at 324.

words, the specific contours of trade secret law are part of the utilitarian effort to balance the rights afforded to individuals with the benefits flowing to the public.

The channeling function provided by some aspects of trade secret law is not an anomaly. A variety of IP doctrines are channeling rules, directing protection to one regime or the other, or to the public domain. Copyright law's useful article doctrine provides that "useful articles" may not be copyrighted because such items belong in the patent realm or the public domain.[144] Similarly, trademark's functionality doctrine dictates that "functional" marks may not be protected by the trademark regime because to allow such protection would be, in essence, a backdoor patent achieved without satisfying the rigors of a patent examination.[145] A variety of subject matter rules perform similar channeling functions.[146] Just as there are disputes about the proper balance within any one area of protection, one may of course dispute the proper balance between trade secret law and patent law, for example, or between copyright law and patent law. But there is no doubt that attempting to find this balance is fundamental to the IP ecosystem. In other words, one cannot evaluate any particular IP doctrine in a vacuum; some attention must be given to the broader picture.

Because noncompetes are regularly used as—and justified as—a form of IP protection,[147] their use must be evaluated in light of IP policy and the availability of other forms of IP protection. The various IP regimes seek to achieve some kind of balance between public access to inventive and creative products and the rights necessary to provide an incentive for the creation and invention of those products.[148] The balance that has been struck may hardly be

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144. Brandir Int'l, Inc. v. Cascade Pac. Lumber Co., 834 F.2d 1142, 1146-47 (2d Cir. 1987).

145. TrafFix Devices, Inc. v. Mktg. Displays, Inc., 532 U.S. 23, 29 (2001).

146. Copyright's idea/expression dichotomy is one example. *See* Baker v. Selden, 101 U.S. 99, 102 (1879) ("To give to the author of the book an exclusive property in the art described therein, when no examination of its novelty has ever been officially made, would be a surprise and a fraud upon the public. That is the province of letters-patent, not of copyright."). Patent law's refusal to protect abstract ideas is another example. *See* Funk Bros. Seed v. Kalo Inoculant Co., 333 U.S. 127, 130 (1948) (noting that abstract ideas are "manifestations of ... nature, free to all men and reserved exclusively to none"). Trade secret's requirement of secrecy performs a channeling function as disclosure is required in order to obtain a patent; thus an inventor must make an election between the two regimes.

147. *See supra* note 88.

148. *See supra* note 136.

described as perfect, but permitting alternative means of protecting IP—such as noncompetes—without understanding how they affect that balance will disrupt that balance and interfere with efforts to improve it.

B. Noncompetes Fail as an IP Tool

Employment law scholars have explicated a host of concerns about noncompetes in the context of the employment relationship.[149] Viewed as an effort to protect IP, noncompetes look even more problematic. Reviewing the variety of mechanisms that may be used to protect intangible firm assets, it becomes clear that using noncompetes is part of a "belt-and-suspenders" approach to IP protection. This approach relies on the assumption that more protection is always better, but this assumption is faulty. As many observers have described, upstream rights may inhibit downstream innovation.[150] In addition, as summarized above, private gain is not one of the primary purposes of providing IP protection. Instead, providing a sufficient, but not excessive, incentive to invent and create is the goal.[151] Given this, the contours of trade secret and other IP protections make some sense, but the IP justification for noncompetes begins to make no sense.

The IP justification for noncompetes is not necessarily wrong,[152] but it is certainly misplaced. Noncompetes are simply not a good

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149. *See supra* Part I.

150. *See, e.g.*, Bilski v. Kappos, 130 S. Ct. 3218, 3255 (2010) (Stevens, J., concurring) (stating that "[i]nnovation in business methods is often a sequential and complementary process in which imitation may be a '*spur* to innovation' and patents may 'become an *impediment*.'" (quoting James Bessen & Eric Maskin, *Sequential Innovation, Patents, and Imitation*, 40 RAND J. ECON. 611, 613 (2009))); Michael A. Heller & Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research*, 280 SCI. 698 (1998); Robert P. Merges & Richard R. Nelson, *On the Complex Economics of Patent Scope*, 90 COLUM. L. REV. 839, 916 (1990) ("[E]very potential inventor is also a potential infringer. Thus a 'strengthening' of property rights will not always increase incentives to invent; it may do so for some pioneers, but it will also greatly increase an improver's chances of becoming enmeshed in litigation."); Heather Hamme Ramirez, Comment, *Defending the Privatization of Research Tools: An Examination of the "Tragedy of the Anticommons" in Biotechnology Research and Development*, 53 EMORY L.J. 359, 368 (2004).

151. *See supra* note 133 and accompanying text.

152. That is, there may be a need for IP protection, but noncompetes simply are not a good method of IP protection, particularly because the other effects of the agreements, on individual employees and the labor market, are so problematic. *See supra* Part I.

tool for protecting IP rights. First, to the extent that noncompetes are used as a supplement or an alternative to IP protection, we ought to be concerned that they may upset the balance struck by the IP regimes between protection and disclosure; that is, between private rights and the public availability of inventions, information, and creations. Second, even if there is a need for additional protection, consistent with IP policy, noncompetes are not the solution to that problem as they fail to address the public goods problem that IP rights are generally meant to solve and, as tools for protecting IP, they are underbroad.[153]

First, assuming that the existing IP regimes are perfectly calibrated, the use of noncompetes is likely to interfere with that system. In other words, IP law is in some ways *intentionally* limited. Indeed, if anything that was not protected by patent law or copyright law could be protected by some mechanism exogenous to the IP regimes, the balance struck by the federal IP statutes between protection and availability and between secrecy and disclosure would be destroyed.[154] There would be no reason for inventors or creators to go through the costly and expensive process of obtaining a patent. The Supreme Court's preemption jurisprudence in the IP area, conflicting and unsatisfactory though it is, recognizes as much.[155]

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153. *See* O'Malley, *supra* note 2, at 1231-32.

154. Goldstein v. California, 412 U.S. 546, 559 (1973) ("[A] conflict would develop if a State attempted to protect that which Congress intended to be free from restraint or to free that which Congress had protected.").

155. The Court has not been entirely consistent in this regard, but overall the preemption cases make clear that the IP regimes cannot be viewed in isolation. Although in *Kewanee* the Court stated that "the patent policy of encouraging invention is not disturbed by the existence of another form of incentive," Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470, 484 (1974), the opinion also points to the limitations of trade secret law in reasoning that there is no conflict, *id.* at 489-90. And in other cases, the Court has struck down state laws as interfering with the incentive function provided by federal patent law. *See, e.g.*, Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 141 (1989) (preempting a Florida statute that prohibited copying of unpatented boat hulls); Compco Corp. v. Day-Brite Lighting, Inc., 376 U.S. 234, 237 (1964) (holding that for a state to "forbid copying would interfere with the federal policy, found in Art. I, § 8, cl. 8, of the Constitution and in the implementing federal statutes, of allowing free access to copy whatever the federal patent and copyright laws leave in the public domain"); Sears, Roebuck & Co. v. Stiffel Co., 376 U.S. 225, 232-33 (1964) ("But because of the federal patent laws a State may not, when the article is unpatented and uncopyrighted, prohibit the copying of the article itself or award damages for such copying. The judgment below did both and in so doing gave Stiffel the equivalent of a patent monopoly on its unpatented lamp.") (citation omitted).

Trade secret law plays a role in this balancing act. The contours of trade secret law perform a channeling function, directing some kinds of inventions to the patent system and others to the purview of state trade secret law—or to no protection at all. If noncompetes were permitted to fill this state-law hole, even partially, the channeling function performed by trade secret law would be undermined.[156] A refusal to enforce noncompetes would recognize that some of the limitations of trade secret law ought not to be remedied. It would, in other words, perform a channeling function of its own. The argument that noncompetes are necessary as an alternative or supplement to trade secret rights, then, collapses if the "weakness" in trade secret law is intentional, operating to direct certain inventions to the patent realm or dictating that the item not be protectable.

Even to the extent that trade secret law is *unintentionally* or improperly weak, the IP justification for noncompetes is unpersuasive. If trade secret protection is insufficient on its own terms and within the larger scheme for protecting IP (that is, if it fails to achieve what it seeks to achieve) the solution to that problem lies more properly with the areas of law directed at protecting intangibles—patent or copyright law, nondisclosure agreements, duties of loyalty and confidentiality, and doctrines governing the ownership of human capital—than with noncompetition agreements. With this understanding, a refusal to countenance noncompetes would serve a different kind of channeling function, encouraging development of trade secret law, whereas the continued use of noncompetes discourages changes in the legal regime that may more effectively serve the IP justification.

The IP justification fails even when other forms of IP protection are insufficient because noncompetes are simply not a good tool for achieving the purposes of IP protection. Even assuming that there is a need for a greater incentive to produce, invest in, and disclose intangibles, noncompetes are unlikely to provide that incentive. First, they operate bluntly and only indirectly to provide that incentive and to protect IP assets. Second, the empirical work performed so far on the effects of noncompetes on innovation indicates that the agreements simply do not provide much, if any,

156. *See supra* Part II.A.2.

incentive;[157] accordingly, they cannot be justified on a utilitarian basis. Indeed, studies indicate that firms may in fact be better off overall under a regime in which noncompetes are unenforceable.[158]

As a method for protecting IP, noncompetes work only indirectly. They are essentially a "backdoor" method of trade secret protection because contract law is not generally a good tool for addressing the concerns implicated by the IP justification.[159] IP rights operate against the world, whereas contract rights do not. Noncompetes in particular do not address the public goods problem very well because they do not seek to control the *thing* society seeks to incentivize. Rather, noncompetes use control over *people* as a proxy for controlling things. A noncompete restricts not the use of a good or an invention but the labor of the creator. Put simply, noncompetes regulate the *inputs* to creation and invention, whereas IP rights regulate the inventive or creative *outputs*.[160] Because noncompetes regulate employees rather than their inventive or creative results, noncompetes are a blunt instrument for the IP task.

In addition, as described in detail above, there are a variety of collateral problems involved in enforcing noncompetes: restrictions on employee mobility, broader effects on the labor market, and so on.[161] Oddly, then, noncompetes are both too broad, given their problematic aspects, and at the same time perhaps too narrow —because they do not operate as rights against the world—if in fact there is an insufficient incentive for the kinds of intangibles employers seek to protect with noncompetes.

This argument about the misfit between the IP justification and noncompetes is buttressed by recent empirical work. The stud-

157. *See infra* notes 167-90 and accompanying text.

158. *See infra* note 166.

159. Contract law may be very effective for the efficient transfer of IP rights.

160. I borrow the terminology from Matt Marx. He discusses it as follows: In the case of IP rights,

> [t]he deadweight loss is often rationalized *ex ante* in that the good never would have been invented in the first place if not for promise of a non-zero monopoly price. In the case of non-compete agreements, however, the deadweight loss bears a less direct relationship to the incentive to invest because ... non-competes restrict access to the *inputs* of the innovative process instead of the *outputs*.

Marx, Good Work, *supra* note 73, at 48 (emphasis added).

161. *See supra* Part I.

ies—limited though they are—indicate that noncompetes simply may not provide much of an incentive to innovate, and perhaps do not contribute to overall economic development.[162]

The IP justification is based on the assumption that a firm is likely to be harmed, presumably in terms of its growth, profitability, or productivity, if it cannot impose noncompetes on its employees.[163] This is another version of the incentive argument: that there will not be sufficient investment in the absence of this form of protection. There is, however, some evidence that these assumptions do not hold up, and that, in fact, the free mobility of labor contributes to economic development of firms and to increased innovation because of the knowledge spillovers created by employees moving from one employer to another.[164] Some studies do indicate that there are costs to firms associated with these knowledge spillovers (that is, that employers lose something when employees leave for a competing firm), but that those costs are outweighed by the benefits conferred by the spillovers received from other firms and the increased productivity of employees.[165] Therefore, it may be that a firm's incentives to invest in employees, to disclose information to employees, and to innovate are not sharply reduced by a legal regime in which noncompetes are unenforceable.[166] This evidence undermines—if it does not completely destroy—the IP justification for the enforceability of noncompetition agreements.

In a well-known study comparing Silicon Valley in California with Route 128 in Massachusetts, two prominent high tech areas, AnnaLee Saxenian described the divergent performances of the two regions. In 1965, Route 128 firms employed roughly three times as many people in the technology sector as Silicon Valley did, but by 1990, Silicon Valley companies had many more people employed in

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162. Stone, *Knowledge at Work*, *supra* note 92, at 758; *see also* Bar-Gill & Parchomovsky, *supra* note 64, at 1656.

163. Stone, *Knowledge at Work*, *supra* note 92, at 746.

164. *See infra* notes 167-90 and accompanying text.

165. *See generally* Norman D. Bishara, *Covenants Not To Compete in a Knowledge Economy: Balancing Innovation from Employee Mobility Against Legal Protection for Human Capital Investment*, 27 BERKELEY J. EMP. & LAB. L. 287, 308, 310 (2006); Brett M. Frischmann & Mark A. Lemley, *Spillovers*, 107 COLUM. L. REV. 257, 258 (2007).

166. *See* O'Malley, *supra* note 2, at 1230 ("The positive economic impact of employee mobility may suffice to override any policy concerns regarding the protection of an employer's interest in retaining its employees.").

that sector than Route 128 did.[167] Saxenian concluded that Silicon Valley's "culture of mobility" explained a great deal of the differential performance between the two industrial districts.[168] According to Saxenian, the transfer of knowledge by employees moving from one firm to another was conducive to technological innovation and economic growth.[169] In her view, Silicon Valley's "efficiency advantage, and the resulting performance gap" with Route 128 was attributable to differences between the business cultures in the two regions.[170] Notably, employees in California were significantly more mobile, changing jobs much more frequently than employees in the Route 128 area.[171] Some have called this "high velocity" employment.[172]

In a 1999 article building on Saxenian's work, Ronald Gilson attributed Silicon Valley's high rates of employee mobility and Route 128's relatively lower rate to, most significantly, the difference in the two states' approaches to noncompetes.[173] Gilson

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167. ANNALEE SAXENIAN, REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128, at 3 (1994); *see* Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not To Compete*, 74 N.Y.U. L. REV. 575, 587 (1999) ("In 1995, Silicon Valley reported the highest gains in export sales of any metropolitan area in the United States, an increase of thirty-five percent over 1994; the Boston area, which includes Route 128, was not in the top five.").

168. SAXENIAN, *supra* note 167, at 111-15. Other research supports Saxenian's conclusion. *See, e.g.*, Richard Gordon, *Innovation, Industrial Networks, and High-Technology Regions*, *in* INNOVATION NETWORKS: SPATIAL PERSPECTIVE 185-91 (R. Camagni ed., 1991) (arguing that employee mobility leads to increased innovation and economic growth because of the transfer of information among firms); *see also* Richard C. Levin, *Appropriability, R&D Spending, and Technological Performance*, 78 AM. ECON. REV. 424, 427 (1988) (suggesting that information spillovers between firms do not negatively affect spending for research and development). There is no consensus on this issue, of course. Some have asserted that there may be *too much* employee mobility, arguing that employee mobility is beneficial to individuals but imposes costs on the economy as a whole. *See* RICHARD L. FLORIDA & MARTIN KENNEDY, THE BREAKTHROUGH ILLUSION: CORPORATE AMERICA'S FAILURE TO MOVE FROM INNOVATION TO MASS PRODUCTION 91 (1990).

169. SAXENIAN, *supra* note 167, at 34-37.

170. Gilson, *supra* note 167, at 578 (describing Saxenian's view).

171. SAXENIAN, *supra* note 167, at 34 (stating that in Silicon Valley, "engineers shifted between firms so frequently that mobility not only was socially acceptable, it became the norm").

172. *See* Gilson, *supra* note 167, at 591 (defining "high velocity labor markets" as those with "rapid employee movement both between employers and in connection with founding start-ups").

173. *Id.* at 578. Gilson described this as an "alternative explanation," though it seems to me entirely consistent with Saxenian's account. In fact, Saxenian herself pointed to the differing rules concerning noncompetes as one of the factors influencing employee mobility

described the different legal rules—noncompetes unenforceable in California, but enforceable generally in Massachusetts—as providing for a "natural experiment,"[174] the results of which he presented as quite clear: "Because California does not enforce post-employment covenants not to compete, high technology firms in Silicon Valley gain from knowledge spillovers between firms. These knowledge spillovers have allowed Silicon Valley firms to thrive while Route 128 firms have deteriorated."[175] Gilson concluded that the legal rule in California invalidating noncompetes was one of the operative mechanisms in increasing economic development and innovation in California.[176] There was increased employee mobility in the absence of enforceable noncompetes so that knowledge "spill[ed] over" to competing firms, leading to increased economic returns and innovation.[177]

The California rule concerning noncompetes was crucial in this story because it solved a collective action problem.[178] According to Gilson, "[w]hile it would be in the interest of the region's firms collectively to facilitate employee mobility even at the expense of diluting the intellectual property of individual firms, it will be in the interest of any individual firm to impede the mobility of its own employees."[179] In other words, when noncompetes are enforceable, firms will use them in an individually rational but collectively irrational way. Gilson concluded that the California rule against the enforcement of noncompetes served a coordinating function, "solv[ing] the collective action problem associated with encouraging knowledge spillover through employee mobility."[180] According to Gilson, there was a causal connection in this case between the legal rule (noncompetes unenforceable) and the high velocity employment

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and the resultant knowledge spillovers. SAXENIAN, *supra* note 167, at 35.

174. Gilson, *supra* note 167, at 578.

175. *Id.* at 575; *see also* Pivateau, *supra* note 42, at 692 (claiming that because of noncompetes, "employers may be deprived of access to well-trained employees, even those subject to otherwise unenforceable agreements").

176. Gilson, *supra* note 167, at 578.

177. *Id.* at 579 ("Knowledge, especially tacit knowledge, 'spills over' between firms through the movement of employees between employers and to start-ups.").

178. The rational actor argument would be that if knowledge spillovers brought about by employee mobility are value enhancing, "[i]ndividual firms acting in their own self-interest will elect not to interfere with employee mobility." *Id.* at 595. This standard account does not, however, take account of the collective action problem.

179. *Id.* at 596.

180. *Id.* at 579-80.

in Silicon Valley, and it was high velocity employment that led to better outcomes for the region as a whole.[181]

More recent studies on noncompetes have confirmed Gilson's view that firms did not necessarily act irrationally, on an individual basis, in imposing noncompetes.[182] There are some demonstrated benefits for firms in binding their employees to noncompetes. They are more likely to pay lower wages (which is related to the bargaining and consideration point made in Part I.B.1), retain employees (which is related to the employee mobility point discussed in Part I.B.2),[183] and experience reduced competition from others in the market.[184] Notably, each of these is the flip side of the arguments *against* the enforceability of noncompetes, such as the flaws in the bargaining process and the effects on the labor market. The benefits to individual firms thus appear to come at the cost of some other interests: employee mobility, commercial exchange, and a competitive marketplace.

As Gilson and others pointed out, this individual rationality may be collectively counterproductive.[185] The evidence indicates that industrial sectors as a whole experience more growth and development when a legal regime prohibits noncompete enforcement.[186] In another study based on the Michigan "natural experiment," Matt Marx, Jasjit Singh, and Lee Fleming concluded that noncompetes

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181. *Id.* at 596-97 ("[T]he regime of high velocity employment appears to have resulted from the legal infrastructure's failure to provide complete protection for an important category of intellectual property.").

182. Burk & McDonnell, *supra* note 125, at 632.

183. *See supra* notes 62, 73 and accompanying text.

184. Sterk, *supra* note 33, at 408.

185. Burk & McDonnell, *supra* note 125, at 632; *see also* Fosfuri & Rønde, *supra* note 127, at 47.

186. *See, e.g.*, Fosfuri & Rønde, *supra* note 127, at 63 ("A system of trade secret protection based on covenants not to compete or the possibility to seek an injunctive relief behave quite differently from one based on punitive damages. Indeed, stronger protection does not affect clustering. Instead, it prevents technology spillovers from arising when firms locate in the same region. In this sense, our model provides some support to Gilson's ... claim that the lack of enforceable covenants not to compete has spurred labor mobility and innovation in Silicon Valley."); On Amir & Orly Lobel, *Innovation Motivation: Behavioral Effects of Post-Employment Restrictions* 36 (Univ. of Cal. San Diego Legal Studies Paper No. 10-32, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1639367 (discussing the collective action problem and concluding that legal rules such as California's prohibition on noncompetes "can be viewed as addressing this collective action problem" described as "a prisoner's dilemma where everyone is better off with the optimal free flow of information but single players instead maintain secrecy and create high walls").

play a role not just "within a region but *across regions* as well—with harmful implications where the use of such contracts is sanctioned."[187] They described their findings in rather stark terms:

> [N]oncompetes contribute to a "brain drain" of the most valuable knowledge workers from regions that enforce them to those that do not, driving away those with higher levels of human and social capital while retaining those who are less productive or connected. Over time, this process contributes to the accumulation of elite inventors in regions that prohibit enforcement.[188]

Another recent study bolsters the conclusion that noncompetes may be counterproductive for firms. Although many firms contend that noncompetes are necessary to protect their investment in employees, it may be that in some circumstances the presence of noncompetes actually reduces the employee's incentive to "invest in their work performance."[189] The empirical work thus demonstrates that, in a variety of ways, noncompetes impose substantial costs and provide little benefit.[190] In such a situation, legal regulation makes sense.

The notion that *less* protection—in this case, the unenforceability of noncompetes—increases both economic growth and innovation contradicts the standard law and economics argument about IP assets. The argument proceeds as follows: "In the absence of complete protection, producers will not capture all of the gains resulting

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187. Matt Marx, Jasjit Singh & Lee Fleming, Regional Disadvantage? Noncompete Agreements and Brain Drain 2 (July 21, 2010) (unpublished manuscript), *available at* http://portale.unibocconi.it/wps/allegatiCTP/MarxSinghFleming2009.pdf.

188. *Id.*

189. Amir & Lobel, *supra* note 186, at 35. In an experimental study, On Amir and Orly Lobel found that "certain conditions of post-employment contractual restrictions may negatively impact motivation." *Id.* In those cases, the presence of the noncompete restriction may reduce the firm's innovation and economic growth.

190. I have described the strong version of this argument: a legal rule permitting the enforcement of postemployment restraints hampers the economic development of firms and the regions in which those firms operate. The studies done to date have focused on just a few jurisdictions and on certain sectors of the economy. Virtually all of the studies have focused on higher-wage employees and on the technology sector. Even taking these limitations into account, however, it remains significant that no studies have concluded that noncompetes are procompetitive or substantially assist firms in protecting their assets.

But if one is unwilling to accept the strong version of the argument, even the weak version undermines the IP justification. The weak version is that the rule against enforcement of noncompetes does not hurt firms, at least not significantly, and is not, on balance, inefficient.

from their efforts, and too little intellectual property will be produced."[191] Similar arguments are made with respect to investments in "human capital." There is concern, for example, that "without some assurance that employees will perform long-term employment contracts, employers might well underinvest in development of firm-specific human capital."[192] The evidence on noncompetes indicates that more rights—contract rights, in this case—do not necessarily lead to greater economic returns.[193] I certainly do not intend to enter into that broader debate here, but there is sufficient evidence in the context of noncompetes that cognitive and behavioral factors on the part of both employees and employers may well lead to the imposition of noncompetes that are not just unfair to employees but are useless, or perhaps even counterproductive, for employers.

I have argued that noncompetes are used primarily as a tool for protecting IP or IP-like assets. Understood as an IP tool, noncompetes are a failure. Some of the perceived flaws in trade secret law are not mistakes; they are instead part of the larger regime for protecting, or not protecting, IP. To the extent this is the case, the "weakness" of trade secret law simply does not justify the imposition of noncompetes. To the extent that trade secret and other IP rules provide *unintentionally* insufficient protection, noncompetes are not the solution. They are the wrong tool for the IP job because they do not address the public goods problem effectively and are unlikely to provide the incentive for invention that animates the IP justification.[194]

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191. Gilson, *supra* note 167, at 620-21 (citing MICHAEL J. TREBILCOCK, THE COMMON LAW OF RESTRAINT OF TRADE: A LEGAL AND ECONOMIC ANALYSIS 152-53 (1986)); *see also* Kitch, *supra* note 22, at 710 (discussing the standard law and economics approach but also recognizing Silicon Valley's success in the absence of noncompetition agreements, citing it as "[a]nother bit of evidence that the real world does not operate as logic suggests").

192. Sterk, *supra* note 33, at 393.

193. Gilson, *supra* note 167, at 621 ("[T]he comparison is between the average per firm cost of diluted intellectual property protection and the average per firm benefit associated with the preservation of the high technology industrial district."). This is, obviously, an empirical matter, and one I cannot address here, but, as Gilson suggests, "the difference in performance of Silicon Valley and Route 128 is a little more than casual." *Id.*

194. *See* O'Malley, *supra* note 2, at 1231-32 ("Limiting the enforcement of covenants not to compete would simply force employers to rely more heavily on statutory protection of trade secrets rather than on contractual solutions. Although the standard of proof in a trade secret dispute is often difficult and expensive to meet, this statutory scheme ensures that only the most legitimate business interests take priority over the important public policy concerns regarding employee mobility."). On the differing approaches to legal regulation of human

CONCLUSION

Change is afoot in noncompete law. In the past few years, the California Supreme Court emphatically affirmed that state's refusal to enforce the agreements, a number of states are in the process of reforming the doctrine, and the ALI is in the end stages of drafting a Restatement (Third) of Employment Law that addresses the enforceability of noncompetes. Given these various developments, a reexamination of the use and operation of the agreements is called for.

The existing critiques have focused on only part of the story. Although employment law scholars have persuasively argued that noncompetes are a deeply problematic aspect of the employment bargain and have thus undermined the freedom of contract rationale for enforcement of noncompetes, insufficient attention has been paid to the other primary justification for noncompetes—the IP justification. Understanding that noncompetes are used as IP tools and that they are particularly bad tools for that job knocks out the very foundation of noncompete enforcement.

The conclusion drawn from the bargaining process and mobility concerns is that only some noncompetes should be enforced. This is true at least in part because courts are unlikely to hold noncompetes unenforceable. Contract doctrine does not often allow for classes of contracts to be held unenforceable. Asking courts to inquire, either on a case-by-case or broader basis, as to the efficiency or efficacy of particular transactions leads down a slippery slope undermining the predictability and consistency provided by current doctrine. In other words, arguments concerning the bargaining process and employee mobility problems will likely lead to reform of the doctrine, but not to elimination of noncompete enforcement.

Although it is not surprising that noncompetes provide no benefit to employees, it is counterintuitive that they also provide little to no benefit to firms, to the labor market, to regional or national economic development, or to innovation. Yet this is precisely the direction that the empirical work points. That work buttresses the argument that noncompetes, which are used primarily to protect IP or IP-like assets, are the wrong tool for that job. Once noncompetes

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capital, see generally Rubin & Shedd, *supra* note 113.

are understood this way, it becomes clear that incremental doctrinal reform is simply insufficient. In this new light, the concerns are focused not only on employees, the employment relationship, and the labor market, which are significant factors in themselves, but also on the IP regimes and the incentives necessary to promote innovation and encourage economic development.

The conclusion drawn from the IP concerns is that noncompetes should simply be unenforceable, and it is legislatures rather than courts that ought to make that change. Rather than asking courts to consider noncompetes on a case-by-case basis, the appropriate response to the concerns about noncompetes is a legislative solution. The evidence concerning the effects of noncompetes on employees and the arguments about the role of noncompetes in the overall scheme for protecting IP are policy arguments that should be directed to policymakers and, indeed, ought to be quite compelling to policymakers.[195] In other words, a legislative approach provides a substantially better solution than an incremental common law decision-making approach.

Simply suggesting that firms avoid the use of noncompetes will not be effective. As Gilson indicated, the possibility of noncompete enforcement creates a collective action problem: it is individually rational but collectively irrational for firms to impose noncompetes on their employees.[196] Gilson argued that the California rule prohibiting noncompete enforcement solved this collective action problem by operating as a binding mechanism.[197] In other words, this is a situation in which regulation makes sense.

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195. *See* Marx et al., *supra* note 187, at 6 ("From a regional policymaker's perspective, the free flow of talent to the best opportunities is beneficial as long as it occurs locally; workers who take out-of-state jobs are a loss to the region. Prior work has shown that non-competes deter intra-regional mobility[;] ... this article establishes that non-competes are responsible for a brain drain from enforcing states to non-enforcing states. Taken together, these results suggest that the state sanction of non-competes is a lose-lose proposition at the regional level, especially in light of recent evidence that R&D investment remains strong and effective in regions which prohibit enforcement.") (citations omitted).

196. *See supra* note 178 and accompanying text.

197. *See supra* note 180 and accompanying text.